FEDERAL COURT OF AUSTRALIA

Virk Pty Ltd (in liq) v YUM! Restaurants Australia Pty Ltd [2017] FCAFC 190

Appeal from:	*Diab Pty Ltd v YUM! Restaurants Australia Pty Ltd* [2016] FCA 43
File number:	NSD 1671 of 2016
Judges:	**GILMOUR, NICHOLAS AND MOSHINSKY JJ**
Date of judgment:	28 November 2017
Catchwords:	**CONTRACT** – implied terms – implication of duty or obligation of good faith and reasonableness – franchise agreement – where franchisor had discretionary power to set maximum prices for products – where parties accepted that power subject to duty of good faith – scope of duty of good faith and reasonableness – whether franchisor was obliged to act reasonably in an objective sense **NEGLIGENCE** – franchise agreement – whether franchisor owed duty of care to franchisees in exercising power to set maximum prices for products – where franchisee alleged that franchisor owed franchisees a duty to exercise power so that franchisees could make, maintain or increase profits **CONSUMER LAW** – unconscionable conduct – franchise agreement – where franchisee alleged that franchisor had engaged in unconscionable conduct in setting maximum prices for products
Legislation:	*Competition and Consumer Act 2010* (Cth), Sch 2, Australian Consumer Law, ss 21, 22 *Federal Court of Australia Act 1976* (Cth), ss 33H, 33ZC

Cases cited:	*A & A (Sydney) Pty Ltd v YUM! Restaurants Australia Pty Ltd* [2014] FCA 678 *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349 *Astley v Austrust Ltd* (1999) 197 CLR 1 *Australian Competition and Consumer Commission v Lux Distributors Pty Ltd* [2013] ATPR 42-447; [2013] FCAFC 90 *Australian Competition and Consumer Commission v Seal-A-Fridge Pty Ltd* (2010) 268 ALR 321 *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266 *Brookfield Multiplex Ltd v Owners Corporation Strata Plan 61288* (2014) 254 CLR 185 *Burger King Corporation v Hungry Jack's Pty Ltd* (2001) 69 NSWLR 558 *Caltex Refineries (Qld) Pty Ltd v Stavar* (2009) 75 NSWLR 649 *Codelfa Construction Pty Ltd v State Rail Authority (NSW)* (1982) 149 CLR 337 *Colin R Price & Associates Pty Ltd v Four Oaks Pty Ltd* (2017) 120 ACSR 451; [2017] FCAFC 75 *Commonwealth Bank of Australia v Barker* (2014) 253 CLR 169 *Commonwealth Bank of Australia v Kojic* (2016) 341 ALR 572 *Jones v Dunkel* (1959) 101 CLR 298 *Macquarie International Health Clinic Pty Ltd v Sydney South West Area Health Service* (2010) 15 BPR 28,563; [2010] NSWCA 268 *Marmax Investments Pty Ltd v RPR Maintenance Pty Ltd* (2015) 237 FCR 534 *National Australia Bank Ltd v Nemur Varity Pty Ltd* (2002) 4 VR 252 *Paciocco v Australia and New Zealand Banking Group Ltd* (2015) 236 FCR 199 *Paciocco v Australia & New Zealand Banking Group Ltd* (2016) 258 CLR 525 *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234

Date of hearing:	15, 16, 17 and 18 May 2017
Registry:	New South Wales
Division:	General Division
National Practice Area:	Commercial and Corporations
Sub-area:	Commercial Contracts, Banking, Finance and Insurance
Category:	Catchwords
Number of paragraphs:	300
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Solicitor for the Appellant:	J Kartsounis & Co
Counsel for the Respondent:	Mr NC Hutley SC with Mr KL Andronos SC and Mr SA Keizer
Solicitor for the Respondent:	Webb Henderson

ORDERS

	NSD 1671 of 2016
BETWEEN:	**VIRK PTY LTD (IN LIQUIDATION) (ACN 132 822 514)** **Appellant**
AND:	**YUM! RESTAURANTS AUSTRALIA PTY LTD (ACN 000 674 993)** **Respondent**

JUDGES:	**GILMOUR, NICHOLAS AND MOSHINSKY JJ**
DATE OF ORDER:	**28 NOVEMBER 2017**

THE COURT ORDERS THAT:

1. The appeal be dismissed.
2. The appellant pay the respondent's costs of the appeal, to be taxed if not agreed.
3. There be liberty to apply.

Note: Entry of orders is dealt with in Rule 39.32 of the *Federal Court Rules 2011*.

REASONS FOR JUDGMENT

THE COURT:

INTRODUCTION

1 On 4 June 2014, the respondent, YUM! Restaurants Australia Pty Ltd (**Yum**), the franchisor of the Pizza Hut franchise in Australia, decided to adopt a business strategy called the "Value Strategy" (the **Value Strategy** or **VS**). This strategy comprised various different measures including, significantly for present purposes, reducing the number of ranges of pizzas from four to two, and reducing the prices for the two remaining ranges such that the price for "Classics" pizzas would be reduced from $9.95 to $4.95, and the price for "Favourites" pizzas (formerly called "Legends" pizzas) would be reduced from $11.95 to $8.50. The Classics range of pizzas comprised about half of all pizzas sold by Pizza Hut. The new prices would apply both to pick up (or take-away) pizzas and to delivered pizzas (with an additional charge for delivery in the latter case). The Value Strategy would apply to 300 out of a total of 307 Pizza Hut outlets in Australia.

2 On 10 June 2014, Yum announced the Value Strategy to the franchisees. In so doing, it exercised its contractual power to set maximum prices for pizzas, and certain other powers, under the franchise agreement it had with each franchisee (the

International Franchise Agreement or **IFA**). The Value Strategy was due to be implemented on 1 July 2014. Many Pizza Hut franchisees were bitterly opposed to the Value Strategy. They complained that they would not be able to survive financially if it were implemented. Indeed, certain franchisees sought an interlocutory injunction to prevent the strategy being implemented. The application for an injunction was heard on 24 June 2014 and dismissed that day.

3 On the same day, 24 June 2014, and before Pizza Hut had announced to the market that it would be implementing the Value Strategy, Pizza Hut's main competitor, Domino's Pizza Enterprises Limited (**Domino's**), announced that it would be offering a $4.95 every day price point. Unlike Pizza Hut's Value Strategy, however, Domino's $4.95 price applied only to take-away pizzas. Domino's announcement pre-empted the Value Strategy and, on one view, meant that Pizza Hut lost the 'first mover advantage'.

4 The proceeding below was commenced by Diab Pty Limited (**DPL**), a franchisee, as the representative applicant of all persons who were franchisees under an International Franchise Agreement with Yum to operate Pizza Hut outlets in Australia as at 1 July 2014 (**Franchisees**). DPL contended that Yum breached contractual duties, including implied terms, in adopting the Value Strategy and setting the new prices. DPL also contended that Yum was liable in negligence and had engaged in unconscionable conduct contrary to statutory provisions.

5 DPL's case at first instance failed: *Diab Pty Ltd v YUM! Restaurants Australia Pty Ltd* [2016] FCA 43 (the **Reasons**). The primary judge made a number of important findings that were adverse to DPL's case. In particular, her Honour found that "Yum and, in particular Mr Houston [the General Manager of Pizza Hut South Pacific], carefully considered the appropriate maximum price taking into account that it was part of an overall strategy" (Reasons, [363]). Her Honour held that "DPL [had] not established that Mr Houston acted dishonestly or in bad faith or with reckless disregard for the Franchisees" (Reasons, [363]). The primary judge found that, although Mr Houston may

have demonstrated poor business judgment, particularly with the benefit of hindsight, "that does not equate to a lack of fidelity to the bargain or to unconscionable behaviour"; and that Mr Houston "made what he considered to be the best decision from the point of view of Yum and the future profitability of the Franchisees" (Reasons, [368]). Further, her Honour found that Mr Houston clearly believed, "rightly or wrongly but reasonably, that once Domino's offered an everyday $4.95 pizza, Pizza Hut had no choice but to implement the VS" (Reasons, [368]).

6 DPL subsequently resolved its dispute with Yum.

7 The appellant, Virk Pty Ltd (in liq), another franchisee, brings this appeal as a representative party or sub-group representative party pursuant to s 33ZC of the *Federal Court of Australia Act 1976* (Cth). By its notice of appeal, the appellant challenges a number of factual findings made by the primary judge. The appellant does not, however, challenge any of the primary judge's findings as to the subjective state of mind of any officer of Yum. This was reflected in paragraph 3 of orders made on 10 March 2017. That paragraph (made with the appellant's consent) stated that, without leave of the Court, the appellant may not raise any issue on the appeal as to the subjective state of mind of any officer of Yum. The appellant confirmed its position in its oral and written submissions. The appellant challenges the primary judge's conclusions as to whether Yum breached the contractual duties it owed to Franchisees. Broadly speaking, the appellant contends that a tort-like test of reasonableness is to be implied into the International Franchise Agreements between Yum and the Franchisees, and that the primary judge ought to have found that Yum failed to act reasonably in this sense in adopting the Value Strategy and setting the maximum prices. Further, the appellant contends that the primary judge erred in not concluding that Yum was liable in negligence and for unconscionable conduct.

8 Yum has filed a notice of contention. Yum contends that the decision of the primary judge should be affirmed on grounds other than those relied on by the primary

judge. In summary, it contends that:

(a) first, to the extent that the primary judge found that, in setting maximum prices under the International Franchise Agreement, the prices should be reasonably capable of allowing Franchisees to make profits (Reasons, [359]-[360]), the primary judge should have held that Yum was under no obligation other than to exercise that power in good faith and for a proper purpose;

(b) secondly, to the extent that the primary judge found that the object of the International Franchise Agreement was to enable Franchisees reasonably to have the opportunity to run a profitable operation (Reasons, [354]), the primary judge should have found that the object of the agreement was to permit the Franchisees to participate in a unique and valuable franchise system devised by Yum and its affiliates for the preparation, marketing and sale of pizzas and other food products; and

(c) thirdly, to the extent that the primary judge found an implied term of reasonableness formed part of the contract between Yum and its Franchisees (Reasons, [360]), the primary judge should have held that there was no such implied term.

9 For the reasons that follow, we would dismiss the appeal. In relation to the notice of contention, we would uphold ground 1; we do not consider it necessary to determine ground 2; and we would dismiss ground 3.

FACTUAL BACKGROUND

10 The following summary of the factual background is based on the facts found in the Reasons, as supplemented by documentary evidence to which we were taken in the course of the appeal hearing. In some instances, we have also included extracts from some of the affidavit evidence to which we were taken during the appeal hearing, in order to indicate part of the context for her Honour's evaluation of the material, which is set out later in these reasons.

Findings on credibility of witnesses

11 It is convenient to note, at this stage, the findings her Honour made about the evidence of the lay witnesses. At trial, DPL called Danny Diab, the majority shareholder and managing director of DPL. Yum called the following personnel, who were involved in the launch of the Value Strategy:

(a) Graeme Houston, who was employed by Yum as the General Manager of Pizza Hut South Pacific;

(b) Lynne Broad, who was employed by Yum as the Head of Finance and Supply Chain, Pizza Hut;

(c) Kurtis Smith, who was employed by Yum in July 2013 as the Head of Operations of Pizza Hut South Pacific (until January 2014, when he became the Market Director for Pizza Hut in Australia, a position that he held until January 2015);

(d) Fatima Kamali-Syed (**Ms Syed**), who was employed by Yum as the Head of Marketing; and

(e) Devesh Sinha, who was employed by Yum as the National Operations Manager from January 2014 until 15 July 2015.

12 Her Honour made the following findings in relation to their evidence, at [427]-[434] of the Reasons:

> 427 I accept that, in giving his evidence, Mr Diab gave truthful evidence. He gave his evidence clearly and of the matters of which he had knowledge and an opinion. Mr Diab is a very experienced and successful Pizza Hut Franchisee. Mr Diab had strong views on certain matters and was entitled to express those views, in particular as to the VS from his perspective. There was no reason to doubt Mr Diab's integrity.
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> 428 DPL severely criticised the Yum witnesses.
>
> 429 The Yum witnesses are not entrepreneurs. They work for a large organisation in a highly competitive area. Some, like Mr Sinha, have worked in Pizza Hut for a long time and have worked their way up through more senior levels in the organisation. DPL attacked the Yum witnesses' character and their evidence.
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> 430 I do not propose to canvass each and every question and answer. I have dealt with Mr Sinha's evidence. While he may not have had the skills to develop something called a "model", as an accounting tool, he worked

on it to the best of his ability and gave reasons for his final inclusion of the 13 additional labour hours.

431 It was put to Ms Broad that she reconstructed her evidence, in particular as to matters that occurred after she expressed disagreement with the proposed strategy and the ACT Test results. I accept that Ms Broad believed in the accuracy and honesty of her calculations as to the ACT Test at the time and that she had a basis for the inclusion and exclusion of data even though she accepted in cross-examination that some of those bases could be considered to be flawed. That acceptance does not really affect the outcome because the ACT Test results were only one factor in the preparation of the Yum Model and the decision to implement the VS.

432 The least satisfactory witness was Ms Syed who, it seemed, had not monitored Domino's response in the ACT and then, in evidence, gave unconvincing explanations of how it was that she did not know of Domino's television advertising for 5 weeks. However, she notified the Yum leadership team of those advertisements on 13 June 2014. When Mr Houston made his decision to implement the VS, he was fully conscious of Domino's likely immediate response. It is not apparent that after Domino's launched, whether or not they advertised made any difference to the decision to implement the VS, or would have made a difference to the earlier decision to implement that was interrupted by the interlocutory proceeding.

433 **I accept Mr Houston's evidence. He also gave truthful evidence to the best of his ability.** The most that can be said against Mr Houston is that others may not have agreed with his business judgment, but that does not mean that the decisions that he made lacked a reasonable foundation or were wrong.

434 DPL strongly attacked the credit of Mr Smith and it submits that Yum seeks to avoid a finding that Mr Smith gave inaccurate and untruthful evidence to Jagot J [in connection with the interlocutory injunction application] that the form of the Yum Model attached to his affidavit of 23 June 2014 was the model on which Yum had relied to formulate the VS. I do not need to make a determination about the credit of Mr Smith and have not placed reliance on Mr Smith's evidence unless it was a matter to which other witnesses referred.

(Emphasis added.)

13 As noted above, the appellant does not challenge any of the primary judge's findings as to the subjective state of mind of any officer of Yum. Nor does the appellant challenge the primary judge's findings regarding the credibility of the witnesses.

Yum

14 At all relevant times, Yum was an Australian subsidiary of Yum! Brands, Inc. (**Yum US**), which is a publicly listed company on the New York Stock Exchange and among the world's top 250 companies on the Fortune 500 list. Yum operated the Pizza Hut business in Australia.

15 Mr Houston had been a director of Yum since 21 December 2011. Ms Broad became a director in December 2014. At the time of the trial, Mr Smith and Mr Sinha no longer worked for Yum; however, both had roles in Yum US's Dallas headquarters. Mr Smith was the Senior Director of Development of the USA Pizza Hut business and Mr Sinha was the Senior Manager of Operations for what was described at trial as Pizza Hut Global.

16 Mr Houston gave evidence (and, we infer, the primary judge accepted) that, as at 27 November 2014, there were approximately 210 Pizza Hut franchisees in Australia. Of these, approximately 45 franchisees operated more than two outlets and approximately four franchisees operated more than five outlets.

17 In terms of its own financial reporting cycle, Yum provided quarterly reports to the Chief Financial Officer (**CFO**) of Pizza Hut Global, Enrique Ramirez, commencing each year with a forecast known as Q0F, which was then updated in subsequent periods by forecasts known as Q1F, Q2F and Q3F. Ms Broad gave evidence (and, we infer, her Honour accepted) that these forecasts were then built into a consolidated forecast for the Pizza Hut business as a whole.

18 Yum commenced this process in about July of each year when Yum, with every other business unit that was a subsidiary or related entity around the world, submitted a market growth plan. This plan outlined store build and profit targets, which were agreed with the Pizza Hut Global CFO. In about October of each year, there was a conference between Yum's leadership team and the Yum US senior leadership team. During this conference, Yum presented its business strategy, known as the Annual Operating Plan, to

the Yum US senior leadership team. The meeting for the 2014 year took place on 9 October 2013.

Yum personnel

Mr Houston

19 At the relevant times, Mr Houston was employed by Yum as the General Manager, Pizza Hut South Pacific. He had held this position since 2011.

20 Mr Houston was awarded a Bachelor of Commerce from Canterbury University in New Zealand in 1986. He had been employed by Yum, or its related entities, since 1990. His various roles included:

(a) From 1990 to 1994, he held various Area Manager positions in Auckland and Dunedin in New Zealand and Wollongong, New South Wales in KFC Operations (which was a division of Yum at the time of trial). At that time, KFC was part of PepsiCo International.

(b) In 1994, he was promoted to the position of Operations Manager New South Wales KFC.

(c) In 1995, he was promoted to Market Manager for Pizza Hut New Zealand. This was the most senior position in Yum based in New Zealand.

(d) In 1997, Mr Houston was promoted to Market Manager KFC Victoria, Tasmania and South Australia, where he was responsible for 90 company owned restaurants and 48 franchised outlets.

(e) In 2002, he was promoted to Chief Supply Chain Officer for both KFC and Pizza Hut, based in Sydney. In that role he reported to the Managing Director, Yum South Pacific.

(f) In 2003, Mr Houston became the General Manager, Pizza Hut Operations South Pacific, in which he led the Operations team for Pizza Hut in Australia and New

Zealand.

(g) In 2006, Mr Houston became the Vice President of Pizza Hut Delivery Operations of Yum! Restaurants International (which was a division of Yum US). Mr Houston was responsible for developing the Pizza Hut delivery business for all countries in which Pizza Hut did business except the USA and China. He held this position until 2011. During this period, Mr Houston also participated in the Global Pizza Hut Brand Council, which was an annual meeting of 'key thought leaders' from the global Pizza Hut brand to help develop and refine the Pizza Hut brand strategy.

21 In 2013, Mr Houston also assumed responsibility for establishing and developing the Pizza Hut brand in Russia. This role was expanded in 2014, as Pizza Hut Africa was added to his portfolio.

Ms Broad

22 At the time of trial, Ms Broad was employed by Yum as the Head of Finance & Supply Chain, Pizza Hut and had held this position since the middle of 2013. She reported to Mr Houston. Ms Broad had previously held the position of Head of Finance since January 2011. Ms Broad commenced employment with Yum in April 2007 and had held the following roles: Group Taxation & Treasury Manager, Finance Manager and Commercial Planning Manager. Ms Broad was awarded a Bachelor of Commerce from the University of Sydney and a Graduate Diploma from the Institute of Chartered Accountants in Australia. At the time of trial, Ms Broad was a director of Yum (having been appointed to this position in December 2014).

Ms Syed

23 At the time of trial, Ms Syed was the Head of Marketing of Yum and a member of the Leadership Team. Ms Syed had held these positions since January 2013. She had seven employees in her team, five in the Marketing Team and two in the Research and Development Team. Brad Richter was the Marketing Manager and the most senior

person reporting to Ms Syed. Ms Syed began working for Yum in November 2010 as the Group Marketing Manager.

24 Ms Syed was awarded a Bachelor of Business by the University of Technology, Sydney, in 2000 and was awarded a Masters of International Business from the University of Sydney in 2001. At the time of trial, she had worked as a marketing professional in Australia for 12 years, in the following roles:

(a) Assistant Brand Manager at Nestlé Australia Ltd from 2002 to 2004.

(b) Brand Manager at Reckitt Benckiser Healthcare Australia Pty Limited from 2004 to 2006.

(c) Brand Manager at PepsiCo Australia and New Zealand from 2006 to 2008 and Senior Brand Manager from 2008 to 2010.

(d) Group Marketing Manager at Yum from 2010 to 2012.

Mr Sinha

25 Mr Sinha was the National Operations Manager of Yum from January 2014 until 15 July 2015.

26 Mr Sinha had extensive work experience before joining Yum, including:

(a) From 1994 to 1995, he was a Hotel Operations Management Trainee at the Taj Mahal Hotel in Mumbai, India.

(b) From 1995 to 1996, he was the Managing Partner of Zodiac – Multicuisine Restaurant in India.

(c) From 1996 to 1998, he was the Executive of Hotel Services at Eurest Radhakrishna Hospitality Services Pvt Ltd in India.

(d) From 1998 to 2000, he was a District Manager of Domino’s Pizza India.

27 Mr Sinha first worked in the Pizza Hut system in India in 2000 as the Restaurant

General Manager for Favorite Food India (which was a subsidiary of Wybridge, the Master Franchisor for Pizza Hut in Indonesia), where he opened and managed Pizza Hut stores in Mumbai. In that capacity, Mr Sinha had personal experience in making, and supervising the making of, pizzas in a Pizza Hut store. In the period from 2000, Mr Sinha had many roles associated with the Pizza Hut business. These included:

(a) In 2002, he was the Area Coach in Wellington for Restaurant Brands New Zealand Limited (**RBNZ**), the New Zealand Pizza Hut master franchisee. In this role, he managed the operation of the Pizza Hut stores. He stayed at RBNZ until 2006.

(b) From 2006 to 2009, he held the position of Franchise Business Coach and EDI Operations Leader for Yum! Restaurants International in India.

(c) From 2009 to 2011, he was the Area Manager of Southern Restaurants Pty Ltd in Melbourne, Victoria.

(d) In 2011, he became the Pizza Hut State Operations Manager for New South Wales with Yum.

28 In January 2014, Mr Sinha was promoted to National Operations Manager. Each State Operations Manager reported directly to him and the operations team was responsible for maintaining operational standards across all Pizza Hut stores in Australia. Mr Sinha reported directly to Mr Smith. Mr Sinha had the overall responsibility for all operational matters that affected customers, including such matters as food preparation, food and operational safety, and customer service.

Mr Smith

29 At the time of the interlocutory injunction hearing (ie, 24 June 2014), Mr Smith was employed as the Market Director by Yum, a position he had held since January 2014. The role required him to oversee day-to-day operations at Pizza Hut Australia, reporting to Mr Houston.

30 At the time of trial, Mr Smith was the Senior Director of Development in the

Pizza Hut USA business and had held that position since January 2015.

31 Mr Smith was awarded a Bachelor of Science in Business Administration, majoring in accounting, from the University of Richmond, in Virginia in the USA, in 2002. Further, in 2007, he was awarded a Masters of Business Administration from the University of Chicago – Booth School of Business.

32 Mr Smith's professional background was as follows:

(a) From 2002 until 2005, Mr Smith worked as an Associate at Deloitte.

(b) From 2006 to 2009, he was a consultant at Bain & Company.

(c) From December 2009 until October 2010, he was the Senior Manager, Strategy, at Hewlett Packard.

(d) Between October 2010 and July 2013, Mr Smith was employed by Yum! Restaurants International. He held a range of positions including Manager, Strategic Planning (from October 2010 to June 2011), Senior Manager, Strategic Planning (from June 2011 to December 2011) and Director, Financial and Capital Planning (from January 2012 to July 2013).

33 Mr Smith joined Yum in July 2013 as the Head of Operations, Pizza Hut South Pacific.

The International Franchise Agreement

34 Each Franchisee executed a franchise agreement with Yum in materially the same terms (referred to in these reasons as the International Franchise Agreement or IFA). The agreement was for a term of 10 years with a right of renewal for a further 10 years, subject to certain conditions of compliance (clause 18). The agreement provided, in clause 14, that the Franchisee could not sell or transfer any interest in the agreement without Yum's prior written approval of the proposed transferee.

35 Clause 1.1 provided that Yum granted to the Franchisee the right to use a comprehensive system for the preparation, marketing and sale of food products (the **System**). By clause 1.2, the Franchisee agreed to use its best endeavours to develop the Business (defined, in summary, as the business of preparing, marketing and selling approved products) and to increase the Revenues (defined, in summary, as the gross receipts received by the Franchisee as payment for the sale of approved products and for all other goods and services). By clause 2.3, the initial and annual payments made by the Franchisee were in consideration solely for the rights granted in clause 1.1 and not for Yum's performance of any specific obligations or services.

36 The International Franchise Agreement included the following provisions. We set these out at some length in order to provide context for the issues arising on the appeal.

> **BACKGROUND FACTS**
>
> Franchisor and/or its Affiliated Companies have developed a unique and valuable system for the preparation, marketing and sale of certain quality food products under various trade marks, service marks and trade names owned by them.
>
> The System is a comprehensive restaurant system for the retailing of a limited menu of uniform and quality food products, emphasising prompt and courteous service in a clean and wholesome atmosphere which is intended to be particularly attractive to families. The foundation and essence of the System is the adherence by franchisees to standards and policies providing for the uniform operation of all restaurants within the System including, but not limited to, serving designated food and beverage products; the use of only prescribed equipment and building layout and designs; and strict adherence to designated food and beverage specifications and to prescribed standards of quality, service and cleanliness in restaurant operations. Compliance by franchisees with the foregoing standards and policies in conjunction with the trademarks, service marks and trade names provides the basis for the valuable goodwill and wide acceptance of the System. Moreover, Franchisee's performance of the obligations contained in this agreement, and adherence to the tenets of the System constitute the essence of the license provided for herein.
>
> Franchisor is entitled to grant to third parties, and has agreed to grant to Franchisee, the right to use the System, the System Property and the Marks on the terms and conditions of this Agreement.
>
> In this Agreement, capitalised terms have the meanings specified in Schedule A, site-specific information and financial terms are set forth in Schedule B, and contractual modifications and amendments are set forth in Schedule C.

THE PARTIES AGREE:

1. GRANT OF FRANCHISE

1.1 Franchisor grants to Franchisee the right to use the System, the System Property and the Marks for the Term solely in connection with the conduct of the Business at the Outlet and subject to the terms and conditions of this Agreement.

1.2 At all times during the Term, Franchisee will use its best endeavours to develop the Business and to increase the Revenues.

…

1.4 No exclusive territory, protection or other right in the contiguous space, area or market of the Outlet is expressly or impliedly granted to Franchisee. Franchisor reserves the right to use, and to grant to other parties the right to use, the Marks, the System and the System Property or any other marks, names or systems in connection with any product or service (including, without limitation, the Approved Products) in any manner or at any location other than the Outlet. Franchisee acknowledges that, as at the Date of Grant, Franchisor and its Affiliated Companies and franchisees operate Outlets conforming to the Concept and also operate other systems for the sale of food products and services which may be competitive with the System and may compete directly with the Business.

2. INITIAL FEE AND CONTINUING FEE

…

2.2 On or before each Due Date, Franchisee will pay the Continuing Fee to Franchisor. Each payment of the Continuing Fee will be accompanied by a statement of the Revenues for the relevant Accounting Period, in the form required by Franchisor from time to time.

2.3 Franchisee's payments pursuant to Clauses 2.1 and 2.2 are in consideration solely for the grant of rights in Clause 1.1 and not for Franchisor's performance of any specific obligations or services.

3. MANUALS AND STANDARDS

3.1 At all times during the Term, Franchisee must comply with all of·the Standards and the Manuals and all applicable laws, regulations, rules, by-laws, orders and ordinances in its conduct of the Business. The Manuals are incorporated by reference into this Agreement. To the extent of any inconsistency between any provision of the Manuals and any provision of this Agreement, the provisions of this Agreement will prevail.

3.2 Franchisor may at any time change any of the Standards or Manuals or introduce new Standards or Manuals by giving notice to Franchisee. Franchisor will specify in the notice a period reflecting the nature of the change to the Standards or Manuals or the nature of the Standards or Manuals to be introduced, within which the new Standards or Manuals

must be implemented. Franchisee acknowledges and agrees that such changes to, or introductions of, the Standards or Manuals, will bind Franchisee upon receipt of Franchisor's notice as provided in Clause 22 and Franchisee will implement such changes or introductions within the period specified in the notice. In the event of any inconsistency between the Franchisor's version and the Franchisee's version of the Manuals, the Franchisor's version will prevail.

…

4. UPGRADES

Franchisor may, by notice to Franchisee, at any time require Franchisee to upgrade, modify, renovate or replace all or part of the Outlet or any of its fittings, fixtures or signage or any of the equipment, systems or inventory used in the Outlet, in order to procure compliance by Franchisee with the Standards and the Manuals, and Franchisee acknowledges and agrees that such upgrades, modifications, renovations or replacements may require significant capital expenditures and/or periodic financial commitments by Franchisee. In its notice to Franchisee, Franchisor will specify a period reflecting the nature of the upgrade, modification, renovation or replacement, within which the upgrade, modification, renovation or replacement must be implemented and Franchisee will comply with the implementation period specified in the notice.

5. APPROVED PRODUCTS AND SUPPLIES

5.1 Franchisee will not prepare, market or sell any product or service other than the Approved Products or conduct any business other than Business at the Outlet without Franchisor's prior written approval. Franchisor will from time to time notify Franchisee of the Approved Products and will specify those of the Approved Products which must be offered for sale at the Outlet as permanent menu items and at what times.

5.2 Franchisor may, by notice to Franchisee, at any time change or withdraw any Approved Product or add new Approved Products. Franchisee will implement such changes, withdrawals and additions within the period specified in the notice.

5.3 Franchisee will purchase the supplies, materials, equipment and services used in the Business exclusively from suppliers and using distributors who have been approved in writing by Franchisor prior to the time of supply and distribution in accordance with the approval procedures in the Manuals. Franchisee will not have any claim or action against Franchisor in connection with any non-delivery, delayed delivery or non-conforming delivery of any supplier or distributor whether or not approved by Franchisor.

6. ADVERTISING

6.1 Franchisee will not execute or conduct any advertising or promotional activity in relation to the Business or the System without Franchisor's

prior written approval.

6.2 Franchisee will participate in such national and regional advertising, promotions, research and tests as Franchisor from time to time requires and Franchisee will not have any claim or action against Franchisor in connection with the level of success of any such advertising, promotion, research or test.

6.3 Franchisee will spend, in the manner directed by Franchisor in writing from time to time, an amount not less than the Advertising Contribution on advertising, promoting, marketing and researching the products and services of the Business and the System. Franchisor may at any time during the Term direct Franchisee:

(a) to pay all or part of the Advertising Contribution to a national or regional co-operative advertising/marketing fund specified by Franchisor; or

(b) to spend all or part of the Advertising Contribution on such local or regional advertising, promotional and research expenditures as are approved by Franchisor, in accordance with the requirements and guidelines set out in the Manuals, provided that if Franchisee fails to spend the full amount as directed by Franchisor, Franchisee will pay the unspent amount to Franchisor within the period specified in a written demand from Franchisor. Upon receipt of the unspent amount, Franchisor either will contribute the amount to an applicable national or regional co-operative advertising/marketing fund or will spend the amount on national or regional advertising, promotions or research conducted by Franchisor in its discretion.

…

15. DEFAULT AND TERMINATION

15.1 Franchisor may terminate this Agreement by notice to Franchisee effective upon receipt by Franchisee of the notice, and/or adopt any of the remedies specified in Clause 15.2, if any of the following events occur:

(a) Franchisee is unable to pay its debts as and when they become due or becomes insolvent or a liquidator, receiver, manager, administrator or trustee in bankruptcy (or local equivalent) of the Franchisee or the Business is appointed, whether provisionally or finally, or an application or order for the winding up of Franchisee is made or Franchisee enters into any composition or scheme of arrangement;

…

(f) Franchisee abandons or ceases to operate the Business for more than 3 consecutive days without Franchisor’s prior written approval, provided that such approval will not be unreasonably withheld by Franchisor where the abandonment or cessation is

caused by war, civil commotion, fire, flood, earthquake, act of God, industrial action or unrest which Franchisee has used best endeavours to prevent and remedy, or any other cause beyond Franchisee's reasonable control;

…

(i) Franchisor notifies Franchisee that Franchisee or any Guarantor has breached any term or condition of this Agreement (other than Clauses 1.3, 5.1, 8, 9, 13 and 14) or any other agreement between Franchisor and Franchisee and/or any Guarantor (or their respective Affiliated Companies) relating to the Business and Franchisee or the Guarantor does not fully cure the breach to Franchisor's satisfaction within the cure period which is specified by Franchisor in the notice as reflecting the nature of the breach; or

(j) Franchisee or any Guarantor breaches any term or condition of this Agreement (other than Clauses 1.3, 5.1, 8, 9, 13 and 14) or any other agreement between Franchisor and Franchisee and/or any Guarantor (or their respective Affiliated Companies) relating to the Business in circumstances where, in the preceding 24-month period, Franchisee has been sent 2 notices pursuant to Clause 15.1(i), whether or not Franchisee or the relevant Guarantor cured the prior breaches to Franchisor's satisfaction.

…

15.3 Without limiting Clause 15.2, if any of the events specified in Clause 15.1 occur, Franchisor may, in addition and without prejudice to its rights under Clause 15.1, take control of the Business for such period as Franchisor considers appropriate, for the purpose of rectifying any breach of this Agreement and retraining Franchisee and/or Franchisee's employees at Franchisee's cost, such cost to be payable by Franchisee within the period specified in a written demand from Franchisor. During this period, Franchisee and its employees must continue to attend the Outlet to perform their responsibilities in the conduct of the Business, but subject to the directions of Franchisor. Any obligations, liabilities or costs incurred in respect of the Business during this period will be Franchisee's responsibility and the indemnity in Clause 12.2 will apply. Franchisee agrees that the provisions of Clause 17 will also apply in respect of any entry into the Outlet by Franchisor pursuant to this Clause.

…

16. CONSEQUENCES OF TERMINATION

16.1 Immediately upon the expiration or termination of this Agreement, Franchisee will:

(a) pay all amounts owing to Franchisor;

(b) discontinue all use of the Marks and the System Property and otherwise cease holding out any affiliation or association with

Franchisor or the System unless authorised pursuant to any other written agreement with Franchisor;

(c) dispose of all materials bearing the Marks and all proprietary supplies in accordance with Franchisor's instructions; and

(d) if Franchisor so requires, de-identify the Outlet in accordance with Franchisor's instructions.

…

16.3 For 60 days from the termination of this Agreement, Franchisor will have the option to purchase, or to nominate a third party to purchase, any of the supplies held by Franchisee at cost price and any of the equipment or signage at the Outlet at a price equal to book value less depreciation or as otherwise agreed, and free of any charges or other security interests.

…

23. MISCELLANEOUS

23.1 This Agreement constitutes the entire agreement between the parties with respect to its subject matter and supersedes all prior negotiations, agreements or understandings.

23.2 Franchisee is an independent contractor and is not an agent, representative, joint venturer, partner or employee of Franchisor. No fiduciary relationship exists between Franchisor and Franchisee.

…

FRANCHISEE'S REPRESENTATION

Franchisee represents to Franchisor that:

(a) Franchisee has reviewed this Agreement with the assistance and advice of independent legal counsel and understands and accepts the terms and conditions of this Agreement;

(b) Franchisee has relied upon its own investigations and judgment in entering this Agreement, after receiving legal and financial advice, and no inducements, representations or warranties other than those expressly set forth in this Agreement, have been given in respect of the System, the Business or this Agreement; and

(c) Franchisee acknowledges that establishment and operation of the Business will involve significant financial risks and that the success of the Business will depend upon the skills and financial capacity of Franchisee and also upon changing economic and market conditions and that such risks, skills and conditions are not in any way guaranteed or underwritten by Franchisor.

…

SCHEDULE A – DEFINITIONS

…

Approved Products means the products from time to time approved by Franchisor for sale in the Business.

Business means the business of preparing, marketing and selling the Approved Products under the Marks at the Outlet pursuant to this Agreement.

…

Manuals means the manuals, notices and correspondence published or issued from time to time by Franchisor in any form, containing the Standards and other requirements, rules, procedures and guidelines relating to the System.

…

Outlet means the outlet conforming to the Concept at the address specified in Schedule B.

…

Revenues means all gross receipts received by Franchisee as payment for the Approved Products and for all other goods and services sold at or from the Outlet or the Business and all service fees but excludes sales or other tax receipts required by law to be remitted, and in fact remitted by Franchisee, to any government authority and no adjustment for cash shortages from cash registers will be made.

Standards means the standards, specifications and other requirements of the System as determined, changed or added to by Franchisor from time to time, including, without limitation, the standards, specifications and other requirements related to the preparation, marketing and sale of the Approved Products, customer service procedures, the design, décor and fit-out of the Outlet, the equipment at the Outlet, and the content, quality and use of advertising and promotional materials.

…

SCHEDULE B – INFORMATION SCHEDULE	
Advertising Contribution: (Clause 6)	6% of Revenues to be spent as follows until otherwise directed by Franchisor pursuant to Clauses 6.3 and 6.4: • 5.5% of Revenues (plus GST) to be paid by Franchisee to Pizza Hut Adco Limited on or before each Due Date; and • 0.5% of Revenues to be spent by Franchisee on local advertising and promotions approved by Franchisor in each Accounting Period
…	

Continuing Fee:	6% of Revenues (plus GST)
…	
Initial Fee: (Clause 2.1)	US$23,850 to be adjusted for US CPI on 1 April each year and converted to AUD$ equivalent at the exchange rate quoted by Westpac on 1 April of each year (plus GST) being at the Date of Grant AUD$25,135 (including $2,285 GST)
…	
Renewal Fee: (Clause 18(h))	US$11,925 to be adjusted for US CPI on 1 April each year and converted to AUD$ equivalent at the exchange rate quoted by Westpac on 1 April of the year of the commencement of the Renewal Term (plus GST)

…

SCHEDULE C – ADDITIONAL PROVISIONS OF FRANCHISEE AGREEMENT

C1.	**MAXIMUM RETAIL PRICE** Franchisee will not permit any Approved Products to be sold at the Outlet at any price exceeding the maximum retail prices advised by Franchisor to Franchisee from time to time.
…	
C12.	**UPGRADES** Subject to the renewal criteria of Clause 18 and Schedule B, when determining the period of implementation specified in notices issued by Franchisor pursuant to Clause 4, Franchisor will take into account the rate of implementation of the upgrade by Franchisor and its Affiliated Companies in their company-owned outlets and will not require Franchisee to implement the upgrade at a faster pace.

37 Although it would appear not to matter for the purposes of the appeal, we note that, on the hearing of the appeal, there was a difference of position between the parties as to the source of the power to set maximum prices that was utilised by Yum in connection with the Value Strategy. On the one hand, the appellant contended (T12-T14, T275-T276) that the source was clause C1 of Schedule C (albeit that the term is expressed as a negative obligation on the Franchisee not to sell products at a price exceeding the maximum price set by Yum). On the other hand, Yum contended (T245) that the source of the power was clause 3 combined with the definition of "Manuals". We

note that another potential source of power was clause 6.2, which dealt with promotions.

Adco

38 Pizza Hut Adco Limited (**Adco**), in conjunction with Yum, was responsible for marketing and promotional activities and promoting the Pizza Hut business, brands and products in Australia.

39 Adco was established in 1998. Mr Houston described it as "a forum that allowed franchisees to have input into how the Advertising Contribution was spent and provided a mechanism for Yum to consult with franchisees, through their elected representatives, on marketing". On 9 May 2013, at an Adco meeting, the Adco directors resolved to increase the marketing services administration fee, to have effect on 1 December 2013. Minutes of the meeting show that Mr Diab voted in favour of the resolution and that two of the Franchisees' Adco directors voted against it. Mr Houston gave evidence (which, we infer, the primary judge accepted) that he knew of no challenge to the accuracy of those minutes.

40 Another meeting of the directors of Adco was scheduled to take place on 18 February 2014. Prior to the meeting, DPL sought some alterations to the terms proposed by Yum in an updated marketing agreement. In particular:

(a) On 30 October 2013, DPL sought clarification of whether the fee Adco would pay to Yum was on the basis of net contributions (which allowed for bad debts) or gross contributions. DPL preferred net contributions.

(b) On 16 December 2013, DPL sought the inclusion of a term that "any recommendation of regular and promotional pricing for PIZZA HUT products must have the unanimous support of all Adco board of directors".

41 Neither of these proposed concessions was incorporated by Yum into the draft of the updated marketing agreement. Yum said at trial that it did not agree to the changes

for the following reasons:

(a) Administratively, it would not be able to execute the change to the clause regarding net contributions and Yum disagreed with the suggestion in principle.

(b) On 19 December 2013, Ms Broad had stated that Yum refused to incorporate the term requiring unanimous support of all Adco directors, as it would waive Yum's right to use its casting vote and the power to set a maximum price, which resided with Yum under the International Franchise Agreement. Yum submitted at trial that what Mr Diab sought was something to which he was not entitled and which, if agreed, would fundamentally change the parties' relationship.

42 At the Adco meeting on 18 February 2014, Yum presented the extent of decline in transaction growth for 2013 and 2014 and the directors discussed the "current value perception" of Pizza Hut. A resolution was sought to approve the updated marketing agreement, which contained an increase in Adco's administrative contribution to Yum. The votes on the resolution were equally in favour and against the resolution. As a result, Yum exercised its casting vote, pursuant to clause 44 of Adco's Constitution, and the updated marketing agreement was approved. On 30 April 2014, the Franchisees' representatives on Adco resigned.

43 There was a dispute at trial as to why the Franchisees' representatives had resigned from Adco. Mr Diab said that it was because they did not want Yum to convey to the Franchisees that Adco had approved the change in price. Yum suggested at trial that Mr Diab refused to attend the next meeting scheduled on 1 May 2014 so that he could obtain control over pricing, which was not a power conferred on him under the International Franchise Agreement. On 29 April 2014, Ms Syed confirmed that pricing would not be raised at the Adco meeting on 1 May 2014. Yum contended at trial that Mr Diab was not content with this assurance and that this was the reason for his resignation.

44 Her Honour considered that there was no need to determine the reason for

Mr Diab's resignation. The fact was that he resigned (Reasons, [128]).

45 After the resignation of the Franchisees' representatives, Adco ceased to function or to approve marketing contributions and expenditure. Yum proceeded with the Value Strategy without Adco's agreement.

The commercial context

46 We were told by counsel for the appellant (T30) (and there did not appear to be any dispute about this) that at the relevant times Domino's had approximately 500 outlets in Australia, while Pizza Hut had approximately 300 outlets. At [408] of the Reasons, the primary judge found that Pizza Hut had lost, and was losing, market share. Counsel for the appellant accepted (T28) that there was no issue that Pizza Hut had been losing market share.

Communications with Yum US in November 2013

47 In November 2013, Yum sought funding from Yum US to conduct a trial of the Value Strategy in the Australian Capital Territory (the **ACT Test**). Yum presented the proposed ACT Test to various members of the Yum US leadership team, as seen by the PowerPoint presentation attached to an email sent by Mr Houston on 7 November 2013.

48 On 13 November 2013, Yum presented to the Yum US leadership team another PowerPoint presentation titled "Step Change Canberra". DPL relied at trial on the following observation on the "Summary" slide:

> If we can demonstrate success this will influence broader community and mitigate need for more costly support in the future when we do roll nationally.

The ACT Test (February to April 2014)

49 The ACT Test was commenced on 4 February 2014 and concluded on 28 April 2014. The ACT Franchisee, who owned all eight outlets in the ACT market,

implemented the Value Strategy during this period with the assistance of Yum.

50 It was not in dispute at trial that Yum's decision to test the Value Strategy in the ACT was appropriate. The primary judge found that test was appropriate for the following reasons:

(a) Yum believed that there was a "value" problem in Australia and it wished to see whether adopting the New Zealand $4.90 strategy would increase sales, transactions and Franchisee profitability.

(b) Conducting a trial of a strategy, such as the Value Strategy, was an appropriate action by a franchisor acting responsibly towards its franchisees, particularly where it had the co-operation and support of the participating franchisee and had agreed to indemnify him or her.

(c) The ACT was an appropriate place to conduct such a test because it was a distinct media market with its own signal, there was a single Franchisee who owned all eight outlets in the market, the Franchisee was one of the better performing Franchisees and the low average current level of per store average (**PSA**) sales meant that there was significant room for improvement.

51 On 8 March 2014, during week 5 of the ACT Test, Ms Broad sent an email to Mr Smith, Mr Houston and Mr Sinha providing her opinion as to the success of the ACT Test. Ms Broad stated the following opinion, based on three weeks' profit and loss data:

> My opinion at this stage is that the test was well worth doing and the marketing team should be congratulated – the sales growth and transaction growth we have achieved in this test have proven beyond doubt to everyone that velocity pricing is the path we need to head down. … Having said that, from a profitability stand point, I believe it's marginal – this is one of our best Franchisee groups and I don't believe they are making the same amount of money they were previously – it's borderline at best at this stage.
>
> …
>
> From my perspective, looking at these numbers, our underlying business model doesn't support velocity pricing … and I believe we should stop the test at the end of week 6 …

52 On 5 April 2014, during week 9 of the ACT Test, Mr Sinha sent an email to Mr Smith, copied to Mr Houston and Ms Syed, with the subject "Doms TV Ad $4.95". The email stated:

> Hi… Just heard Doms have a TV ad for $4.95 in [ACT]... waiting on confirmation… will let you know… Thanks

However, this email does not appear to have been followed up. The primary judge found that Domino's did indeed respond to the new pizza prices in the ACT by television advertising (Reasons, [399]). However, it would appear that Ms Syed did not recognise this fact until some time in June 2014.

53 Domino's responded to the ACT Test by making a $4.95 every day *take-away* offer. It appears that Domino's responded in this way in week 9 of the ACT Test (see the slide set out at [67] below). Senior counsel for Yum accepted (T239) that Mr Houston knew that Domino's had responded to that extent. However, as discussed below, Mr Houston did not know until 13 June 2014 that Domino's had responded with television advertising.

54 On 16 April 2014, during week 11 of the ACT Test, Harpreet Singh sent an email to Jody Nicholas (of Yum), copied to various others at Yum, with the subject line "April Mega Month $4.95* Value Range Pizzas". The email asked whether there was any update on Yum's "plan of action" to "counter" Domino's. On the same day, Ms Syed responded:

> Hi Harpreet.
>
> I hope my email finds you well. I completely understand your concerns with Domino's starting to react to our offer (they have clearly figured out it is not a short LTO,) but we need to remember that we knew they would respond & frankly the only thing that surprised me was the amount of time they took to respond but it is becoming apparent the delay was due to the fact that they probably thought we were running this offer for a short period of time & chose to ignore it initially. From a brand perspective, we need to stay the course of the test as this is the model we are hoping to launch nationally if successful. What we don't want to do is alter the test in such a way that it impacts the potential of a national rollout – like moving Hawaiian into the Classics range, putting a $7.95 Legends coupon into the market when testing a $8.50 price point, etc. We need

> to stay the course we are on & continue to reinforce the message we have established in the ACT.
>
> I know this is probably unnerving & not what you want to hear, let's chat through it further – I will give you a call over the next couple of days.
> Regards,
> Fatima.

The letters "LTO" would appear to stand for "Limited Time Offer" or "Limited Time Only".

55 During the period of the ACT Test there was both an increase in sales and an increase in transactions, as can be seen in the slides set out at [60] and [67] below. It does not necessarily follow, however, that the ACT stores were more profitable during the period of the test.

56 Yum agreed to underwrite any losses suffered by the ACT Franchisee during the test period. As a result of the ACT Test, Yum paid the ACT Franchisee the sum of $143,000 to make good its losses. The ACT Franchisee continued to implement the Value Strategy after 28 April 2014 and Yum also paid the Franchisee $51,000 to make good the losses in this period after the completion of the test.

Communications with Yum US in April 2014

57 On 1 April 2014, Mr Houston sent an email to Kurt Kane, Chief Marketing and Food Innovation Officer at Yum US, and Ms Syed, attaching a PowerPoint presentation relating to the Value Strategy titled "Pizza Hut Australia – Partnering for Profitable Growth". The covering email explained that the PowerPoint presentation was going to form the basis of Yum's approach to Franchisees in a few weeks' time. Mr Houston sought Mr Kane's feedback. The slides in the PowerPoint presentation included the following slide (which has been redacted for confidentiality):

58 The PowerPoint presentation also included a slide to the effect that customer surveys indicated that Pizza Hut had a "value problem". It was stated that: "Over the past 13 years, Pizza consumers in Australia have rated Pizza Hut 24% lower than Domino's in regard to 'Value for Money'."

59 The primary judge did not consider it necessary to make a finding (nor did she consider the evidence sufficient to enable a finding to be made) as to the state of the Franchisees in the Australian market and whether there was a perceived 'value problem' and a decline in market share (Reasons, [409]). However, the primary judge did consider that it was clear from Mr Houston's evidence that "he was of the view that something needed to be done to rectify or reverse what he perceived, based on information provided to him, to be a continuing decline in Pizza Hut's position in the Australian market, in particular with regard to value for money" (Reasons, [409]).

60 The PowerPoint presentation sent to Mr Kane and Ms Syed also contained a number of slides relating to the ACT Test, including the following:

In relation to the above slide, we note that "SSSG" refers to "same store sales growth" and "SSTG" refers to "same store transaction growth". It appears that the figures are, in each case, a comparison with the prior year.

61 On 13 April 2014, Yum approached the Franchisee Policy Committee (**FPC**) in order to obtain plan relief for a national launch of the Value Strategy, which was now being considered. Mr Houston gave evidence describing the FPC as follows:

> The [FPC] is a committee of senior Pizza Hut Global executives in Dallas who consider special requests from Yum business units around the world for the provision of incentives to franchisees outside the parameters of the IFA. The FPC's role includes the review and approve any proposed incentives or deviation from the IFA.
>
> (Errors in the original.)

62 On 14 April 2014, Eliane Setton of Yum US sent an email to Mr Houston, copied to Mr Ramirez and others, with the subject "FPC / Australia / Two-Tiered Value Pricing & Menu Simplification". The email stated:

> Hi Graeme,
>
> The [FPC] is directionally aligned with setting up a two-tiered value pricing ($5 for "classic" pizzas and $8 for "legend" pizzas) and simplified menu (from 37 to 16 items) for the Pizza Hut system in Australia. Enrique [Ramirez] will contact you directly to finalize the mechanics/amounts for the 3 requests you sent through (AdCo contribution ($1MM), SCM write-off ($300K) and G&A for "spend-smarter" expert ($100K)).
>
> In the meantime, please let me know if you would like to discuss further.
>
> Eliane

63 On 22 April 2014, Mr Houston sent an email to Mr Ramirez attaching a PowerPoint presentation in similar form to the PowerPoint presentation entitled "Pizza Hut Australia – Partnering for Profitable Growth" referred to above. The PowerPoint presentation included the slides headed "Business trajectory unsustainable" and "Result: Sales and transactions JUMPED!" (with slightly different figures for week 8).

64 On 23 April 2014, Mr Ramirez responded to Ms Setton's email. His email stated:

> Hi Eliane –
>
> I had a chance to connect with Graeme and we are now fully aligned on their two-tiered value pricing plan including the 3 requests that you mention below (none of them is subject to Plan relief, FYI). The plan is approved from my perspective and Scott has signed off as well.
>
> Thanks.
> Enrique

65 On the same day, Mr Houston sent an email in response to Mr Ramirez's email. Mr Houston's email stated as follows:

> Thanks Enrique, appreciate the support. We are very excited about the ability to change the game once and for all in Australia and this goes a long way to ensuring success. Given the test result of 30% growth and the probability that we can replicate this nationally we are confident that it will not impact plan for balance of yr.

Game on!!

Early May 2014

66 On 5 May 2014, Russel Creedy, the Chief Executive of RBNZ, the sole New Zealand franchisee, sent Mr Houston an email that stated that the “secret” to the strategy that had been adopted in New Zealand was to maintain the number of labour hours despite the higher volumes, and that in New Zealand they had been able to prevent an increase in labour costs to meet the additional transactions.

Meetings with Franchisees on 14 and 15 May 2014

67 On 14 and 15 May 2014, meetings took place between Yum and Franchisees. Yum gave a presentation entitled “Franchisee Update May 2014” (the **May 2014 Franchisee Update**). This included a number of slides that were similar to the PowerPoint presentations sent to Yum US referred to above. One of the slides was headed “Business trajectory unsustainable” and was similar to the slide set out at [57] above. The presentation also included a number of slides relating to the ACT Test, including the following:

68 Another slide in the May 2014 Franchisee Update contained the following financial analysis of the ACT Test:

69 As recorded in the Reasons at [52], DPL contended at trial that Yum represented to the Franchisees, in the May 2014 Franchisee Update, that there had been a $425 per week per store improvement in comparable profit in weeks 5-10 of the ACT Test. Yum submitted at trial that weeks 1 to 4 were not included in the figures presented to Franchisees on 14 May 2014 because the results in that period were not in a “steady state” and that this issue was not challenged by DPL. Yum also submitted that weeks 11 and 12 were not included because of the impact of the Easter and ANZAC Day holidays.

Yum submitted that, at the time of the presentation, Ms Broad did not have profit and loss statements from the ACT Franchisee. DPL contended at trial that the calculation of the $425 improvement was "simply a product of financial engineering by Ms Broad that does not withstand reasonable scrutiny". The primary judge found that DPL had not established that Ms Broad engaged in deliberate "engineering" of the results, but that it had established that the presentation did not include relevant data, which may have affected the conclusions that could be drawn (Reasons, [52]).

70 DPL submitted at trial that the true position, which was neither revealed to the Franchisees nor to Jagot J on the hearing of the interlocutory injunction application on 24 June 2014, was that the ACT Franchisee had incurred a loss during the ACT Test of approximately $140,000, for which it was compensated by Yum pursuant to the indemnity or "backstop" arrangement. Further, Yum had also agreed to pay an additional $51,000 to the ACT Franchisee for its post-test losses on the basis that it maintained the Value Strategy prices following the conclusion of the test.

71 At trial, DPL submitted, relying on the May 2014 Franchisee Update, that there were two elements that comprised the calculation of the alleged $425 improvement in per week per store profit as a result of the ACT Test:

(a) an alleged post-launch profit for weeks 5-10 of $155 per week per store; and

(b) a prior year loss of $270 per week per store.

72 The primary judge noted that Ms Broad conceded that the $155 per week per store figure was taken from the adjusted profit and loss figures for weeks 5-9 (in Exhibit AO), not weeks 5-10 as stated in the above presentation document. In cross-examination, Ms Broad stated that the calculation of $155 was only until week 9 and then Yum "double-checked to see if week 10 made a difference to that number". DPL contended at trial that Ms Broad invented this answer in the witness box to "attempt to cover up this relatively

trivial slip".

73 The primary judge found that the figure of $155 per week per store was calculated on the assumption of a contribution of 1.5% of sales for local store marketing (**LSM**) costs. DPL argued at trial that Ms Broad arrived at this figure by "stripping out" LSM costs in excess of 1.5% and that this approach was not according to normal accounting practices of "matching" expenses and revenues. DPL analysed the full 12 week profit and loss for the ACT Franchisee, who incurred a 1.8% charge for "Local Store Marketing – Leaflet" costs and a 4% charge for "Additional LSM". On this basis, the ACT Franchisee incurred costs equating to 5.8% of sales during the ACT Test that were as a result of LSM.

74 The primary judge noted that Ms Broad had explained that the 4% Additional LSM was not actually spent by the ACT Franchisee on LSM but was paid by it to Yum as a contribution to the overall marketing budget for the ACT Test. Nonetheless, DPL contended at trial that Yum failed to account for all marketing expenses when determining net profit and arbitrarily cut off the LSM expenses at 1.5% of sales rather than accounting for the 5.8% in total marketing expenses. It followed, DPL said, that if Yum had taken the full cost into account, the amount of extra cost would have been at least three times the amount calculated for LSM expenses in the May 2014 Franchise Update, and an overall loss would have been calculated. The primary judge noted that Ms Broad did not object to this proposition if DPL's calculation was correct and if it was appropriate to take the Additional LSM into account.

75 Yum acknowledged at trial that the ACT Franchisee did provide 4% Additional LSM. However, it contested the argument that the 4% should have been taken into account when analysing whether the ACT Test was profitable. Ms Broad said that she was "trying to get an understanding of what would happen to the [profit and loss] of a store if we launched the pricing strategy nationally" and that the 4% Additional LSM was required to replicate the marketing budget that would be used nationally. Yum submitted

at trial that the "matching principle" was not appropriate in the circumstances because Ms Broad was analysing the impact on profitability that the Value Strategy would have upon a national rollout and the 4% Additional LSM would not be replicated on a national level. That is, the expense would not be incurred by the Franchisees on a national level, as the Franchisees' contribution to the overall marketing budget would be what they currently paid.

Emails regarding New Zealand strategy (20 and 22 May 2014)

76 On 20 and 22 May 2014, there was an exchange of correspondence between Mr Houston and Mr Creedy. On 20 May 2014, Mr Creedy sent an email to Mr Houston with the subject line "NZ $490 Strategy". It would seem that the proposed Value Strategy for Pizza Hut in Australia (at least in general terms) had come to Mr Creedy's attention. The email relevantly stated:

> I have been asked about the New Zealand $4.90 strategy and the selling of stores for $1million as a result of the big turn around. Although we have not been privy to the briefings held with Australian Franchisees and the decisions YUM! Pizza Hut are making regarding the future strategies, I want to make sure Restaurant Brands strategy and results are not being relied on to justify a similar strategy for the Australian market.
>
> We previously discussed the significant differences between the two markets, such as:
>
> 1) RBL was losing a substantial amount of money on Pizza Hut and therefore the down side and risk was evaluated as acceptable at the time. My understanding is that the Australian Franchisees are not in a similar position. Please be very cautious as once started the strategy can not be turned off.
>
> 2) NZ had down sized the pizza pans to cut the product costs by over 25%, making the strategy possible.
>
> 3) NZ labour rates are substantially lower ($14.25/hr vs about $20/hr in Australia). Low labour costs are imperative to succeed with a similar strategy.
>
> 4) Despite the initial transaction and sales lift over the first few periods, it required transactions to almost double and labour hours frozen at pre-discount levels before the business produced positive EBIT. I understand the ACT test has only delivered between 15% - 30% more sales and I assume this is insufficient to justify the level of discount.
>
> 5) RBL has a cost advantage over Dominos in many ways including media buying, cost of ingredients, freight, fixed cost and we have the same number of

stores in the market.

> 6) Dominos were caught with their pants down and did not respond for several periods as they assumed RBL could not maintain the strategy, but as per point (1) above we had no alternative. I suspect Dominos will not sit back in Australia but will activate an aggressive counter strategy and with almost double the number of stores Dominos should have the advantage.
>
> Graeme, there are many more market differences we can highlight and I request you only rely on market test results in Australia to provide data for future price strategy decisions.

77 Mr Houston responded by email on 22 May 2014. Mr Houston's email stated in part:

> Thanks for the email Russel, I would like to clarify a couple of points that you have raised
>
> I can assure you that we have not solely relied on the NZ results when determining our approach in Australia. The 2.5 years of sustained sales and profit momentum as a result of your $4.90 strategy is clearly something we wanted to learn from. Building on the learning we tested and validated a similar model in a test market in Australia. We only included the slides that you had approved in the presentation deck but we thought it was important to share because we wanted to show the Australian franchisees that it it was not just a short term spike but sustained over 2 years. We also wanted to show that NZ and the Au test market performed very consistently.
>
> I actually would argue that the markets are more similar than different, the test results were very consistent with the Au test performing a little more strongly in the first 12 weeks. Dominos also run the same marketing calendar in NZ. That said we validated the concept in a 12 week test in australia.
>
> Consistent with NZ 2 yrs ago many of the Australian franchisees are facing sales levels that require a step change, not all franchisees obviously but a growing and significant proportion are facing a similar question that you faced.
>
> NZ resized the pizzas around the same time as Australia, around 2009 which was 2 yrs before the decision to launch the $4.90 strategy.
>
> The relative labour rates are a little more complex to compare. Aust has youth rates which are lower than the nZ labour rate, whilst the adult rate is higher, the final outcome depends on your ability to optimize the labour mix. I agree with your assessment on the importance of locking the labour hours, we got the same learning in the test market despite the sales lift actually being more than the NZ results. Success depends on controlling these costs
>
> It is impossible to predict any competitive response but interestingly the response in the test market was similar to what you saw in NZ.
>
> I absolutely agree with your comments about getting the cost lines right and that is something that will be different between the two countries and why testing in

australia was so important.

(Errors in original.)

78 While Domino's had a greater number of stores compared with Pizza Hut in Australia at the relevant time, that was not the case in New Zealand (see the Reasons at [380] and Mr Diab's affidavit of 19 June 2015 at [63](a)).

The Yum Model

79 In late May 2014, Yum began to prepare a model to assist it in deciding whether to implement the Value Strategy (the **Yum Model**). Mr Houston gave evidence (which, we infer, the primary judge accepted) that Ms Broad was responsible for the Yum Model and that Mr Smith's role was to "validate and refine it".

80 Through an iterative process of entering various inputs, Yum concluded, based on the Yum Model, that if the proposed new lower prices were adopted, transactions would need to increase by approximately 34.5% for the national average store to 'break even'. (The word "transaction" is used to refer to a bundle of sales to a particular customer on a particular occasion. For example, a single transaction may comprise the purchase of two pizzas and a soft drink.) This would require an increase of 218 transactions per store per week (from 635 transactions to 853 transactions per week). It is important to note that the object of the model was to determine the transaction uplift needed for the average store to 'break even', that is, to retain the same EBITDA after the introduction of the Value Strategy (Reasons, [395]). It was not designed to predict the transaction growth likely to result from the adoption of the Value Strategy (Reasons, [77]).

81 The Yum Model drew a distinction between two sales channels, take-away and delivery, as it recognised that customers have different behavioural patterns in these two channels. The parties were agreed at trial that delivery customers are less price-sensitive than take-away customers. For example, delivery customers were considered more likely to pay a higher price for drinks than were take-away customers.

82 Six iterations of the Yum Model were in evidence at trial, and DPL tendered a summary comparison of those models. The Yum Model was brought into existence in late May 2014 and refined in early June 2014. Yum submitted at trial that the Yum Model first emerged on 28 May 2014 and was worked on from that date to 3 June 2014. DPL contended at trial that the inputs for the Yum Model were not finally settled until 19 to 23 June 2014, when a copy of the Yum Model was produced for the purpose of exhibiting it to Mr Smith's affidavit for the interlocutory injunction hearing on 24 June 2014. DPL argued that this was clear from the change in the labour rate from the $15 per hour rate that was used in the Yum Model up to 19 June 2014 to the $14 per hour rate appearing in the Yum Model exhibited to Mr Smith's affidavit sworn on 23 June 2014.

83 DPL noted at trial that Mr Houston had conceded in cross-examination that the Yum Model, in the form presented at the interlocutory injunction hearing on 24 June 2014, had been changed after 4 June 2014 (when the decision was made by Mr Houston to adopt the Value Strategy: see [95] below). This version of the Yum Model indicated that 13 additional labour hours would be needed to accommodate the transaction uplift caused by the introduction of the Value Strategy. In support of its contention regarding changes to the Yum Model, DPL referred to an email from Travis Purcell to the Yum leadership team on 6 June 2014 attaching a version of the Yum Model containing an input of nine additional labour hours. DPL also referred to a subsequent email from Mr Purcell on 19 June 2014 that attached a version of the Yum Model with 10 additional labour hours. DPL put to Mr Sinha that this attachment was the latest version of the Yum Model at that time and that the assumptions in it were still being revised. Mr Sinha disagreed with this contention, as he said that the assumptions had already been made on 4 June 2014.

84 Yum submitted at trial that the Yum Model was discussed on 3 and 4 June 2014 at a meeting of Yum's leadership team (discussed below), where it was displayed on a screen. Yum pointed out that Mr Sinha gave evidence that the 13 additional labour hours had been included in the Yum Model during the course of the meetings on 3 and 4 June

2014 and that he had no further consultation with any person after that time concerning labour hours. Yum argued at trial that there was no reason not to accept this evidence, as the discussion about labour hours at the 4 June 2014 meeting occurred when the Yum Model was on a screen and the document was not saved at that date. Even though the 6 June 2014 version contained nine additional labour hours and the 19 June 2014 version contained 10 additional labour hours, Yum argued at trial that this did not contradict Mr Sinha's evidence, because his evidence was that the 13 hours had not been saved as an input at the time of the 4 June 2014 meeting.

85 During the appeal hearing, we were taken, in particular, to an extract from the version of the Yum Model exhibited to Mr Smith's affidavit for the interlocutory injunction (AB Pt C, tab 8). This version contains 34.5% as the transaction uplift percentage necessary for the national average store to 'break even'. It also includes, as an assumption, that an additional 13 hours of variable labour would be required to process the additional 218 transactions that would occur if there was a 34.5% increase in transactions. There is no finding in the Reasons as to precisely when this version of the Yum Model was produced. In any event, it is convenient to refer to this version of the Yum Model for the purposes of considering certain issues raised by the appeal. We reproduce below a copy of this version of the Yum Model. To assist readability, we have split the first page of the document into two halves. The left-hand side of the first page was as follows:

We make the following observations about the above extract from the Yum Model. First, the figure for the transaction uplift (namely 34.5%) appears in row 4, column B. Secondly, the figures appearing in row 6, column B (Classics mix) and row 7, column B (TA Ticket) are derived from column L of the spreadsheet (reproduced below). Thirdly, the figures for "Store Profile" in column E are weekly figures. Fourthly, in the lower part of the above extract there is a table containing the heading "Now". That heading refers to the position of an average store before implementation of the proposed Value Strategy.

Fifthly, the reference to “Net Profit” in that table would appear to be a reference to EBITDA.

86 The right-hand side of the first page of the Yum Model was as follows:

The reference to “Test Results” in the heading in columns H and I is to the ACT Test results.

87 The second page of the Yum Model was as follows:

We make the following observations about the above extract from the Yum Model. First, the figure of 635 appearing in row 2, column I represents (on an average basis) the existing number of transactions per store per week. Secondly, the increase in transactions referred to earlier (namely, an increase of 218 transactions per week) appears in row 31, column I. Thirdly, the figure of 13 hours per week for extra labour hours appears in row 36, column I.

88 At trial, DPL did not criticise all aspects of the Yum Model. DPL stated that it was “a very useful EBITDA model for Australian Pizza Hut outlets, and was capable of being [sic] to evaluate the impact of the VS upon those outlets through the consideration of the ‘national average’ outlet”. To this extent, DPL said that it accepted Ms Broad’s evidence that “[m]odelling a store on a national average basis is a standard financial average technique used in the business”.

89 DPL accepted at trial all of Yum’s inputs into the Yum Model other than the input for “variable labour”. As has been noted, Yum made an assumption in the version of the Yum Model extracted above that an additional 13 hours of variable labour would be required to process the additional 218 transactions that would occur if there was a 34.5% increase in transactions.

90 Mr Sinha placed the additional 13 hours of variable labour assumption into the Yum Model. At trial, Yum summarised how Mr Sinha derived his assumption as follows:

(a) Mr Sinha first calculated the minimum number of weekly labour hours that would be required to staff a Pizza Hut outlet, given Yum's rules about minimum staffing levels. This was 97 hours of management, 70 hours of team member time and 40 hours of delivery drivers who also assist in the store. That is, the total was 207 hours. Mr Sinha formed the view that these hours were more than sufficient to service the pre-Value Strategy transaction level of 635 transactions per week. Mr Sinha gave evidence that 70 team member hours when divided by 635 transactions produces a "minutes per docket" (**MPD**) of 6.6. (The word 'docket' is used interchangeably with 'transaction'.) Mr Sinha observed that this figure was less efficient than the New Zealand benchmark of 5.6 and the results achieved during the ACT Test. Accordingly, Mr Sinha concluded that an MPD of 6.6 was reasonable and, therefore, that his estimate of 70 team member hours was also reasonable.

(b) Mr Sinha then allocated the 218 additional transactions on a day-by-day basis during the week, maintaining the same relativities on a day-by-day basis as before the Value Strategy. This resulted in a different number of additional transactions for each day, ranging from 20 additional transactions on a Monday to 41 additional transactions on a Friday.

(c) On the basis of Mr Sinha's own experience of utilising labour in Pizza Hut outlets, he formed the view that the existing minimum labour hours would not be fully utilised before the introduction of the Value Strategy. In other words, in Mr Sinha's opinion, the minimum 207 labour hours used before the Value Strategy was capable of producing more than 635 transactions per week.

(d) Mr Sinha then assessed the quantity of additional transactions on each day. He formed the view that the existing level of labour was sufficient to cover the additional number of transactions on Mondays, Wednesdays, Thursdays and Sundays (which ranged from 20 to 28 additional transactions per day). He also formed the view that the

additional number of transactions on Tuesdays, Fridays and Saturdays (which ranged from 37 to 41 additional transactions per day) would require additional labour and allocated additional hours on those days, totalling 13 additional hours for the week.

91 Mr Sinha calculated that an additional 13 team member hours resulted in an overall MPD of 5.84. Mr Sinha noted that MPD rates for the ACT stores during the ACT Test from week 4 of the ACT Test onwards were below 5.6. As the MPD of 5.84 was higher (and therefore less efficient) than both the New Zealand benchmark and the results in the ACT Test (from week 4 onwards), Mr Sinha was satisfied that his calculation of 13 additional labour hours was a reasonable one.

92 Mr Sinha was the internal Yum expert responsible for modelling labour hours and allocating the correct number of additional labour hours. Mr Houston and Ms Broad relied on his expertise in this area. Mr Sinha's evidence at trial (which, we infer, the primary judge accepted) was that Mr Purcell had primary responsibility for the structure of the Yum Model and for entering data into the model and that Mr Sinha assisted in preparing some parts of the Yum Model, including preparing the labour cost figures. Yum did not call Mr Purcell to give evidence at trial.

Yum leadership team meetings on 3 and 4 June 2014 and the decision to adopt the Value Strategy

93 On 3 and 4 June 2014, Yum's leadership team met to discuss whether to adopt the Value Strategy.

94 On 3 June 2014, at 7.46 pm, Mr Houston sent an email to Scott Bergren of Yum US with the subject "Help!" (the **Help! email**). Given the significance of the email to the issues canvassed on the appeal, we set it out in full:

> Scott, I wanted to give you a quick update and see if I can grab a quick call tomorrow. I know we have a call scheduled for next week but would like to talk thru some issues prior to locking away decisions.
>
> I am up and about from 6am which is 1pm your time. I am sure your calendar is

packed but I am hoping to catch a few minutes for a sanity check.

Background

We are at the decision point for the launch of value and need to make the call tomorrow.

We have been working towards a date of July 1 and are at the point of no return tomorrow.

Why the concern ??

1. We have spent the last couple of weeks communicating with franchisees and trying to get alignment and generally the result is poor. Majority of franchisees are very nervous and reluctant to support it. Opting to maintain the status quo (despite knowing that we have no media budget and without YUM support even less). They are collecting signatures for a petition and I understand that they have approx. 120 of the 200 franchisees at this point. It is not a rational decision but that is the reality of a small owner operator model. We are pretty confident that if we launch and fail in any store we will get a law suit. We feel very confident about the due diligence that we have gone thru but the reality is big corp vs small businessman will be tough to win.

2. We have tested the NZ model and got strong results in the ACT, 28% sales growth and 48% transaction growth. The P&L that we have relied on is from a franchisee and whilst we have sliced and diced it as much as we can none of us feel 100% confident about the data. There is nothing more we could do but the reality is we are relying on a franchisee P&L for this launch.

3. The results in the ACT mirrored the NZ result when it came to P&L esp the COS … that gave us confidence that it was robust. What we have been working over the last 2 weeks is how replicable is that data for national launch. It is apparent that we have a number of outliers in the system that will likely need to hurdle a much higher transaction lift to break even. Nationally we need to achieve around 40% transaction lift which given the ACT result is possible … the problem is there is no tolerance for error for the outliers … some of these stores will need 70% plus trans growth ... that is a serious stretch. We are working on tweaking some of the less sensitive prices to ensure that we can still deliver to the tested proposition (sides pricing, delivery min, delivery fee) to improve the margins whilst maintain the headline $4.95 price point.

I guess it is this that I want to bounce off you

We are committed to launching value on July 1. I am nervous about the ability to hit 40% transaction growth and ensure that all (or at least 90%+) of stores make more money given our current economics. I don't think I can build enough margin protection around the outside to bring this number down to a more manageable level (will find this out tomorrow morning).

We are considering launching with $5.95 instead … I know that this sounds

crazy and it may be pre launch nerves but I actually think it is the safer play from a YUM perspective.

Why $5.95

We know Doms will react to a national launch of value and we will not have the ability to sustain a $4.95 price point for more than a few weeks esp if they take our trans growth back to 20% instead of 40% ... franchisees don't have the ability to weather the storm. Whilst $5.95 leaves that price open for them to take and own we also think it is tough for them to own it everyday for exactly the same reasons it is for us … perhaps even more so because they are higher vol. At $5.95 we think our ability to sustain a value proposition for the long term is more likely. The hurdle rate is around 13% vs 40% at $4.95.

The million dollar question is what sort of sales spike can we expect at $5.95 … we didn't test this although the ACT [ran] a test of $6, $8 and $12 for signature pizzas last year and got an 11% sales growth and a 25% transaction growth when we had media … this indicates that it would hurdle esp given the fact that it would have more media support than the test.

It is important to note that even at $5.95 and $8.50 we would be discounting our current pricing by 40% on classics and 30% on favorites … all day everyday.

I am torn between the two options and just want to bounce it off you to get your thoughts. I will check email in the morning if you can make time for a quick call.

95 On 4 June 2014, the day after this email was sent, Mr Houston decided to launch the Value Strategy, with a $4.95 price for Classics pizzas. Although there was an issue at trial as to when the decision was made, it was common ground on the hearing of the appeal (as reflected in the agreed chronology) that the decision was made (by Mr Houston) on 4 June 2014.

96 We now set out the changes in ranges and prices that were to take place under the Value Strategy. The prices of the ranges of Pizza Hut pizzas (with an additional fee for delivery of $8.00) *before* the introduction of the Value Strategy were as follows:

DELIVERY		**PICK UP**	
Range of pizza	**Price**	**Range of pizza**	**Price**
Mia (6 pizzas in range)	$5.00	Mia (6 pizzas in range)	$5.00
Classics (6 pizzas in range)	$9.95	Classics (6 pizzas in range)	$9.95
Legends (8 pizzas in range)	$11.95	Legends (8 pizzas in range)	$11.95

Signature (7 pizzas in range)	$14.95	Signature (7 pizzas in range)	$14.95

97 Under the Value Strategy, the delivery price was to be increased to $8.95, the Legends range was to be renamed as "Favourites" (with the number of pizzas increasing from 8 to 11 in the range) and the Mia and Signature ranges were to be removed. The prices of the ranges of Pizza Hut pizzas were to be as follows:

DELIVERY		**PICK UP**	
Range of pizza	**Price**	**Range of pizza**	**Price**
Mia (6 pizzas in range)	Deleted	Mia (6 pizzas in range)	Deleted
Classics (6 pizzas in range)	$4.95	Classics (6 pizzas in range)	$4.95
Favourites (11 pizzas in range)	$8.50	Favourites (11 pizzas in range)	$8.50
Signature (7 pizzas in range)	Deleted	Signature (7 pizzas in range)	Deleted

98 It is convenient, at this point, to set out some of the evidence of Mr Houston in relation to the decision to adopt the Value Strategy. In his affidavit dated 27 November 2014, Mr Houston stated at [110]-[112], [115] and [121]-[124]:

> 110. On 2 June 2014 I attended Yum's regular lunchtime weekly sales review meeting with the whole of Yum's Australian leadership team. At that meeting I recall we discussed Yum's most recent sales results and the fact that Yum would soon have to decide whether or not to proceed with a value strategy. While there was a general discussion about the merits of implementing a value strategy on that day, no decision was reached and we agreed to reconvene the next day to consider the question in greater detail.
>
> 111. On 3 June 2014, I attended a meeting with a number of Yum's Australian leadership team in the Dynasty Room at Yum's Sydney premises, including Mr Smith, Ms Broad, Ms Syed, Mr Sinha, Travis Purcell and perhaps Glenda Vasco. My purpose in attending the meeting was to determine whether or not to proceed with the value strategy and, if so, what the features of that strategy would be. I considered that the key issues on which I needed to be satisfied were whether the proposed price points of $4.95 and $8.50 would achieve the intended result of increasing transaction volumes enough to improve franchisee profitability.
>
> 112. At the meeting we discussed the various alternatives of launching or not launching a value strategy and what would be the best price points at

which to launch a strategy if Yum did. I recall one participant, whom I believe may have been Kurt Smith, said words to the effect that we should explore pricing Classics pizzas at $5.95 as an option because this price point might be easier for franchisees to manage. We then reviewed a sample of stores that we considered may have been unusual or outliers (such as high delivery, low levels of existing discounts, high volume, low volume) through the model to see how the two price points would affect them if implemented. The team agreed to review the financial impact of the alternatives on these outlets and we would reconvene the next day.

…

115. By the end of the meeting on 3 June 2014 I had nearly reached a decision to proceed with the value strategy including rationalising the menu and setting new price points for Classics and Legends pizzas. I had not made up my mind as to whether the price points would be $4.95 and $8.50 or $5.95 and $8.50. I did want further information on the effects the strategy would have on outliers before making a final decision.

…

121. In my email to Scott [ie, the Help! email] I also express views about the likelihood that Domino's would react to a national launch of a value strategy by Pizza Hut. For the reasons set out below, by 4 June 2014 I had formed the view that while Domino's were very likely to react in some way to a national launch of a value strategy by Pizza Hut, that reaction was not likely to be aggressive or supported by a national advertising campaign involving television advertising. I also believed that any reaction by Domino's would only begin to take effect some weeks after Pizza Hut's own launch.

122. My email refers to a possible transaction growth rate of "20% rather than 40%". I saw this as a worst case scenario if Domino's came back with a major national television campaign. I did not regard it as likely. I noted at the time that the ACT franchisee achieved transaction growth of 48% over the whole of the trial and 61% in weeks 5 to 10. I noted that transactions continued to grow in New Zealand even after Domino's responded. At no time did I regard transaction growth of only 20% as likely but I was nevertheless concerned about what the implications of lower transaction growth would be for franchisees. By the time I decided to proceed with the value strategy on 4 June 2014, I believed it was unlikely that Domino's would respond with a national campaign and the scenario I mentioned in my email to Scott would not eventuate.

123. On 4 June 2014, I met again with Yum's leadership team in the Dougies Room at Yum's premises in Sydney. Present were Kurt Smith, Fatima Syed, Lynne Broad, Davesh Sinha and perhaps Travis Purcell and Glenda Vasco. During the meeting, we reviewed the modelling that had been prepared overnight which was presented to us on a PC projected onto a screen. We discussed the questions that we had decided in the meeting on 3 June 2014 to investigate further, including whether a price point of $5.95 for the 'Classics' range was likely to achieve the same increase in profitability as the proposed $4.95 price point and the impact

of the strategy on certain store types, in particular the outliers we had been discussing.

124. I recall that we discussed possible responses from Domino's during the meetings on both days. There was no discussion of the possibility that Domino's might pre-empt our strategy by launching a value strategy of its own prior to our launch and it did not occur to me that Domino's might do so. I recall we discussed the possibility that Domino's would respond by meeting our price points and that they might do so with an above the line campaign. While some participants thought this more likely than others did, there was discussion that any such response would not occur for several weeks, if at all. We discussed that we expected we would have a window of around 4 to 6 weeks in which Domino's would not be able to respond and that this would have a substantial benefit to Yum in having that price to ourselves for that period. I held these views at the time I made the decision on 4 June 2014 to launch the strategy. I set out the reasons that I took into account below at paragraphs 132 and following.

99 In [124] of the above extract, Mr Houston used the expression "above the line". We were told by counsel for the appellant (T39) (and there did not appear to be any dispute about this) that the expression referred to mass media advertising (eg, advertising on television or the radio). In his affidavit dated 27 November 2014, Mr Houston also stated (at [132]-[143]):

132. As indicated above, one of the issues that concerned me at the time I made the decision to implement the value strategy was what Domino's reaction would be to the launch of the strategy. The nature of the QSR [Quick Service Restaurant] market generally, and the pizza category in particular, is that competitors are constantly acting and reacting with new promotions, products and strategies. It is a dynamic, rather than static, market and both Pizza Hut and Domino's monitor and respond to each other's promotions all year.

133. At the time that I made the decision to implement the value strategy, I had regard to what I considered to be the likely response from competitors. In particular, I considered how Domino's, Pizza Hut's main competitor and the market leader, would respond. This was a topic of some debate amongst the Australian leadership team on 3 and 4 June 2014. I expected that Domino's would react in some way. This was borne out by the whole of my experience in competing with Domino's and the experience of Pizza Hut in New Zealand and Yum during the latter stages of the ACT test. In assessing Domino's likely response, I took into account Domino's response to the value strategies as tested in Western Australia and the ACT and as implemented in New Zealand. In each case, Domino's response, to my mind, was not substantial. In considering whether a competitor's response is substantial or not, I take into account not only the price at which they offer pizzas for sale but the

extent to which they market their products at any reduced price. In my experience, television is the most significant medium as it has the best reach, the greatest impact and is the most expensive.

134. I was aware that in New Zealand it took about 5 months after the introduction of the strategy before Domino's reacted to the $4.90 Pizza Hut price point none of which made any meaningful impact on the New Zealand results. They then sporadically advertised a $4.99 advertising message predominantly below the line with leaflets and local store marketing. Throughout all of 2013 they almost never advertised a value message above the line (i.e. on television) and it was only in 2014 that I became aware of any above the line Domino's advertising message on TV. Pizza Hut sales in New Zealand have continued to be strong over a sustained period. Pizza Hut in New Zealand have achieved 15% same store sales growth in 2013/14 on top of the prior year result of 21% same store sales growth, that is over 35% growth over two years. At tab 16 is a copy of RBL's annual report for 2014. The fact that Domino's did not promote $4.99 consistently and the lack of impact on the New Zealand business gave me heart that if Domino's did respond in Australia, their response would be similar.

135. Similarly, so far as I was aware Domino's did not respond with any television, or "*above the line*", campaign in either Western Australia or the ACT during the tests in those markets. Domino's did respond with some "*below the line*" activity in the ACT, such as in-store advertising, wobble boards and some on-line advertising in April which was the third month of the test.

136. Domino's response was, to my mind, not typical of their responses to other tests we had conducted in the past. In the period 2003 to 2006, Yum's usual practice was to run test markets for major promotions. During those tests, it was my experience that Domino's flooded the market with media or leaflets. I believed that if Domino's were concerned about the ACT test or the WA test, they would have done the same thing again. So far as I am aware, Domino's did not respond with any television advertising during either test. I did hear a single report of one TV advertisement being broadcast in the ACT but did not receive confirmation that this had occurred so concluded that the report was an error.

137. I considered that the fact that Domino's had not responded with television advertising to either of the WA or ACT tests was encouraging and I interpreted this to mean that they would do the same thing in Australia as they had done in New Zealand. I took this into account in considering whether to [implement] the value strategy.

138. I also took into account what I understood to be Domino's higher cost of food as against that of Pizza Hut. I believed Domino's food costs to be higher than Pizza Hut's on the basis of discussions that I have had over the years with ex-Domino's franchisees and from my review of Domino's annual reports. This was to my knowledge higher than Pizza Hut's franchisees' costs. As a result, I believed that Pizza Hut had a cost advantage that would discourage Domino's from attempting to match

and overwhelm Pizza Hut's value strategy. Finally, I took into account the fact that Domino's was the market leader in the category. In my experience, market leaders are usually reluctant to compete aggressively on price and, where a smaller competitor implements a value strategy, it is unusual for a market leader to seek to match that price.

139. Taking the above matters into account, I considered that while there was a risk that Domino's would respond by matching Pizza Hut's prices in the value strategy, it would be unlikely to support that response with aggressive marketing or for a sustained period.

140. Even if Domino's were to respond, I considered that such a response would take at least four to six weeks from our launch date to be implemented. In my experience, implementing a strategy which requires substantial changes to pricing and an aggressive media (particularly television) campaign requires several weeks to implement. Television advertising time, for example, typically takes some 12 weeks to book and anything less can attract a significant cost premium. Further, TV Commercials typically take between 2 and 4 weeks to make. On this basis and assuming that Domino's did not have advance notice of the strategy, I was of the view that any response from Domino's would not affect it for at least four to six weeks.

141. In my view at the time, even if Domino's did respond, the four to six week gap between the launch of the Pizza Hut strategy and any response from Domino's would provide Yum with significant commercial advantages. I believed Pizza Hut would be perceived in the market, and in the media, as the initiator of the value strategy. This would have the benefit of fixing in the consumer's mind that Pizza Hut was now going to offer good value for money, thereby neutralising one of the main negative perceptions about Pizza Hut in the market as being expensive. It would also give Pizza Hut the opportunity to take some customers from its competitors, and even to introduce new customers to the market segment, at least some of whom could be expected to remain loyal to Pizza Hut even after Domino's responded.

142. Yum treated the decision to launch the value strategy as confidential. We did not make any public statements about the launch and did not intend to do so until the launch was imminent. I was concerned that there might be a leak of the strategy when the whole franchisee community were informed of the decision to launch the strategy. For this reason Yum did not inform the franchisees of the decision until 10 June 2014 and asked them to keep all information about the strategy confidential. This was significantly less than the 12 weeks we would normally provide for previous marketing pods. I believed that if news of the decision to launch the strategy nevertheless leaked, that Pizza Hut would still be the first to launch its strategy and obtain the benefits described at paragraph 140 above.

143. Taking into account all of the above matters, I considered that even if Domino's were to respond similar to what they did in New Zealand [or] the ACT after Pizza Hut launched the value strategy, any such response

would not undermine the effectiveness of the strategy.

100 The primary judge found (at [153] of the Reasons) that Yum did not expect Domino's to react to the launch of the Value Strategy by marketing on television, as it thought that Domino's would react through less effective forms of marketing, such as online and through leaflets. It would appear that this finding relates to Mr Houston's state of mind at the time when the decision to adopt the Value Strategy was made (4 June 2014).

Further information about Domino's television commercial (up to 10 June 2014)

101 On 3 June 2014, the same day the Yum leadership team was meeting, Emma Wood from MediaCom sent an email to Mr Richter (of Yum) with the subject "Dominos ACT TVC - $4.95 everday? [sic]". The email stated in part:

> Confidentially the Regional TV guys have confirmed they are running a $4.95 Offer. They cannot tell us if it's all day every day offer or limited to Monday and Tuesday (as their national offer appears to be). It is due to finish at the end of the month, but they will keep an eye on it for us.

The email also referred to a promotion on the Domino's website and included an image of that promotion. This was an offer available in ACT stores only, for Value Range pizzas from $4.95 each (for pick up). Mr Richter forwarded the email to Ms Syed on the same day, stating: "See below regarding Domino's $4.95 in ACT. Can't get the TVC though". We were told by counsel for the appellant (T37) that TVC stands for television commercial.

102 It is convenient to set out some of Ms Syed's evidence on this matter. In her affidavit dated 13 July 2015, Ms Syed stated at [32]-[38]:

> 32. After the conclusion of the ACT test, I heard some reports that Domino's was running a TV commercial in the ACT advertising $4.95 pizzas. I believe this may have been in about late May 2014. This was the first time since the end of the ACT test that I had received a report that Domino's might be running a TV commercial in the ACT that directly addressed the $4.95 every day pricing used by Pizza Hut in the ACT test. Initially I was not able to obtain confirmation about the content of this TV commercial and I was uncertain whether this was a commercial for

the "Cheaper 2-Days" promotion or whether it was a commercial offering $4.95 pizzas all day, every day in the ACT.

33. On 3 June 2014, I received an email from Mr Richter, who is a member of my marketing team, forwarding an email he received from Emma Wood of Mediacom. …

34. In my experience, Domino's uploaded their TV commercials to their YouTube channel. As the emails of 3 June 2014 did not confirm whether the Domino's TV commercial in the ACT offered $4.95 pizza all day, every day or merely on Mondays and Tuesdays, I checked Domino's YouTube channel and I could not find any such advertisement. I also checked Domino's website, where I saw the coupon for $4.95 pizzas in the ACT which was included in Ms Wood's email of 3 June 2014. However, I did not see any television advertisement for a $4.95 offer in the ACT on the Domino's website.

35. Because there was no TV commercial on Domino's Youtube channel or website, I concluded that no TV commercial responding to the ACT test (offering $4.95 pizzas all day, every day) had yet been aired by Domino's in the ACT.

36. On 6 June 2014, I received an email from Mr Richter following his visit to the Domino's website and referring to a video that had been uploaded on Domino's website. In his email, Mr Richter states that he did not believe it to be a TV commercial. …

37. After reviewing the video referred to by Mr Richter in paragraph 36 above, I determined that the video was most likely a TV commercial due to its format. I was unable to determine when the TV commercial went to air but I made the assumption that it had just started running as I had not seen anything on Domino's Youtube channel or its website when I checked them on 3 June 2014.

38. The TV commercial was specific to the ACT and advertised $4.95 pizzas all day, every day. The fact that Domino's had now responded to the pricing in the ACT test with a TV commercial was not the main concern for me. My most significant concern was to ensure that Pizza Hut obtained and maximised a first mover advantage upon launching the Value Strategy nationally.

103 The primary judge stated that she did not accept Yum's evidence that it was unaware of Domino's response in the ACT (including by way of television advertising), although the matter may not have been reported to the Yum leadership team or Mr Houston (Reasons, [399]). It would appear that her Honour was referring to the period *before* 13 June 2014, as she also stated in the same paragraph of the Reasons that "in any event" Ms Syed informed the Yum leadership team of Domino's television commercial on 13 June 2014. It would seem, therefore, that her Honour implicitly found

that Ms Syed or someone else within Yum became aware before 13 June 2014 that Domino's had responded in the ACT with a television commercial. However, her Honour did not make a finding as to precisely when Ms Syed or another person became aware of this.

Yum's communication of the Value Strategy to Franchisees (10 June 2014)

104 On 10 June 2014, Yum informed Franchisees of the prices that would apply as from 1 July 2014 as part of the Value Strategy. We were told by counsel for the appellant (T34) (and there did not appear to be any dispute about this) that the communication was oral, during a telephone conference call. This communication constituted the exercise (or purported exercise) of Yum's contractual power to set maximum prices under the International Franchise Agreement. The detail of the Value Strategy was set out in a document dated 10 June 2014 (AB Pt C, tab 11) that was provided later to Franchisees. As is apparent from this document, the Value Strategy comprised a range of measures, not simply the reduction in the number of ranges and the changes to the prices of pizzas.

Further information about Domino's television commercial (13 June 2014)

105 On 13 June 2014, Mr Richter sent an email to Yash Gandhi, Phil Leece and Caitlin Connolly with the subject "Dominos $4.95 TVC". The email attached a 'wmv' or video file and stated:

> We have just managed to get our hands on this which is a Domino's ad that is currently playing in the ACT talking to $4.95. We are pretty safe to say that if they respond to our rollout, this is what they would respond with.

It is apparent from this email that Yum now had a copy of the Domino's television commercial.

106 On the same day, Ms Syed sent an email to the Yum leadership team with the subject line "Domino's ACT TVC". The email stated:

> Domino's have indeed launched a TVC in ACT with their Value range at $4.95 everyday. TVC is new & similar to what we saw on their website, looks like

> they are ready to respond ATL [Above The Line] when we go live. I believe we should proceed as planned, let's not panic but be prepared for an ATL response.

It appears that a copy of the Domino's television commercial was attached to the email. The primary judge found (at [415]) that Ms Syed did not inform the Yum leadership team of the fact that Domino's had responded with television advertising in the ACT until 13 June 2014.

107 In her affidavit dated 13 July 2015, Ms Syed stated, at [39]:

> On 13 June 2014, I sent an email to Kurt Kane, the Global Chief Marketing Officer at Yum Brands Inc based in Dallas, Texas. As we were getting closer to the launch of the Value Strategy, I kept Mr Kane informed of developments. … I said in the email that:
>
>> "Last week we were made aware of the fact that Domino's had responded to our test market with a TVC, prior to that their response has been via digital, leaflets & in store. Attached is the TVC that is currently running in our test market but I believe it is the ad they will use to respond when we go live nationally on 1/7/14. You will notice they have an "every day" message on their ad which is making me nervous about not having it on ours. We have asked our agency to record 2 versions as per my communication to you last week, but I am now wondering if we should launch with the "all day every day" message rather than wait to see the consumer/competitive response before changing out our message – what are your thoughts?"

Sessions with Franchisees on 18 and 19 June 2014

108 As noted in the agreed chronology, on 18 and 19 June 2014 Yum conducted sessions with Franchisees in Sydney and Melbourne, at which the attendees were taken through the Yum Model.

Domino's response to the Value Strategy (19 to 23 June 2014)

109 Although Yum was presumably unaware of this at the time, documents produced by Domino's in response to a subpoena revealed that, by 19 June 2014, Domino's was aware of Yum's Value Strategy and had made a decision to pre-empt it by launching an all day, every day $4.95 price point. The primary judge did not make a finding as to how Domino's became aware of Yum's Value Strategy. Her Honour considered that it was not

necessary to determine the cause of any leak to Domino's (Reasons, [417]). Domino's notified its franchisees of its decision to pre-empt the Value Strategy on 19 June 2014 (to be announced publicly on 24 June 2014). The primary judge found (at [149]) that Domino's gained the 'first mover advantage' by implementing the strategy first into the market. In this regard, the primary judge noted that, even if Yum had launched the Value Strategy first, it could not have claimed to be the first mover in relation to *any* $4.95 price point, as Domino's had an existing offer in the market for $4.95 on Mondays and Tuesdays and had in the past offered its "value" pizza range at $4.95 on other days as well (Reasons, [149]).

110 DPL noted at trial that Yum, in its opening submissions, had sought to suggest that Domino's became aware of the Value Strategy as a result of the action of Franchisees, and in particular the commencement of a proceeding by A & A (Sydney) Pty Ltd and 79 other Franchisees (including DPL) (the **A & A Proceeding**) on 19 June 2014 (see below). DPL argued that this was speculation on Yum's part and not correct. DPL submitted that although the A & A Proceeding was commenced on 19 June 2014, the first public hearing did not take place until the next day, 20 June 2014. The material produced on subpoena by Domino's revealed that Domino's planned its response at a meeting of its Franchise Advisory Council on 19 June 2014.

111 On 23 June 2014, William Stubbs, a Yum employee in Western Australia, sent to the Yum leadership team an email he had obtained about the response of Domino's (the **Stubbs email**), which evidently comprised the text of Domino's email communication to its franchisees. The Domino's email stated as follows:

> We've had word that the start of the new financial year will see a major competitor adopt an extremely aggressive $4.95 pricing strategy on its value range.
>
> Having faced a similar experience with our New Zealand family, we're not about to sit back and watch it affect our sales and customer count again. We have a plan and we're not afraid to use it!
>
> Domino's is going to be first to market with an aggressive pricing position of its own.

This is what's involved:
We're repositioning our Value Range price point to $4.95 on all digital and TVC advertising from Wednesday 25 June. Print advertising cannot change until 14 July.
We're adding a new pizza to the Value Range – the Beef & Onion.
Simultaneously we're launching a new Value Plus range which includes two new pizzas, as well as moving up some of our more expensive current Value Range pizzas. This range will be priced at $7.95 on the menu.
And because of the all day, every day $4.95 value position, Cheaper Tuesday $7.90 Traditional pricing will cease for those stores still utilising the offer each week.
To ensure you're not losing out, we're going to raise Traditional Range pricing by $1 on all EDMs and other vouchers (where appropriate) and monitor this modification carefully. We will track our Traditional Range customer orders to ensure we understand any behavioural changes in relation to the elevated price.

Key advantages:
Unlike our competitor, the very popular Hawaiian is part of our range. A major added value.
We have not compromised on quality. Our premium ingredients are used in the Value Range.
Only Domino's has the added value of things like Pizza Tracker so customers can place their orders ahead and know when they can come down to collect them. Better than drive through.
We are expecting Monday and Tuesday orders to drop, however the whole week will lift materially. In fact we could expect 15 to 20% customer count lifts with the first month or two.

To further support the campaign there will be an Adfund reduction of 0.5% for the first 2 months and DPE will offer $500k to the Adfund to ensure media weights don't drop.

Please note we will need to honour the $6.95 promo price for the Superlot pizza until 13 July as it's already committed to print distributions. We expect volumes to be relatively low for this however.

What's changing with the Value Range?
The price – it will be $4.95 all day, every day.
We're introducing a new pizza into the Value Range – the Beef & Onion.
The Range will consist of the following pizzas:
Beef & Onion (new pizza)
Ham & Cheese
Hawaiian
Pepperoni
Simply Cheese
Spicy Veg Trio

What's in the $7.95 Value Plus Range?
Bangers & Beef
BBQ Chicken & Ham (new pizza)
Chicken Hawaiian
Margherita

> Rasher Bacon & Mushroom (new pizza)
>
> The BOM will be sent to stores by Wednesday 25 June. Updated pizza make charts, post bake charts and menu translites will be arrive in stores by Friday 27 June.
>
> You can view a low res version of the make chart and post bake chart below:
> Make Chart
> Post Bake Chart
> What you need to do
> All franchisees that have placed print orders with Domino's Direct will need to review the new pricing tiers available and reply to Domino's Direct with their new preferred pricing selection.
>
> Due to the extremely short time frame we have to get this campaign to market, responses are required by COB Monday 23 June.
>
> Print window – urgent action required.
> The earliest opportunity we have to align print with the new $4.95 value pricing is the 14 July. We have updated the print window creative, along with a new range of price tiers for franchisees to choose from. It is very important that you review the new pricing tiers carefully as these are quite different to our previous campaign.
> 70s Range Campaign Weeks 7-9
> Pricing AUS – 70s Range Weeks 7-9
> LSM Order Form AUS Print 70s Range Weeks 7-9
> New point of sale items
> A new menu board panel featuring the $4.95 Value Range pricing and $7.95 Value Plus Range pricing will be sent to stores ahead of launch next week.
>
> Stores will also be sent a new window poster heroing the new Value Range $4.95 price point. This new poster will replace your existing Cheaper 2 Days poster. It is important that both of these items are put up on Friday 27 June.

112 The email set out above was sent by Mr Stubbs to Mr Sinha and Mr Smith at 7.42 pm on 23 June 2014, and to a broader group including Mr Houston, Ms Broad and Ms Syed at 7.49 pm on the same day. Ms Syed forwarded the email to others on the same day, adding the comment: "FYI – not unexpected but really annoying!!"

113 Thus, by the evening of 23 June 2014, Yum knew the details of Domino's proposed response.

The interlocutory injunction hearing (24 June 2014)

114 On 19 June 2014, the A & A Proceeding in this Court was commenced. The

applicants in that proceeding sought an interlocutory injunction to restrain Yum from implementing the Value Strategy.

115 The hearing of the application took place before Jagot J on 24 June 2014. The application was dismissed on the same day: *A & A (Sydney) Pty Ltd v YUM! Restaurants Australia Pty Ltd* [2014] FCA 678.

116 The interlocutory application was made on an urgent basis because Yum intended to implement the Value Strategy imminently and had made at least partly irreversible arrangements on that basis. The grounds for interlocutory relief were, in essence, that under the International Franchise Agreement Yum owed each of the applicants implied duties, being:

(a) a duty to co-operate in achieving the objects of the International Franchise Agreement;

(b) a duty to act reasonably and/or honestly in the performance of duties and exercise of rights, powers or discretions under the International Franchise Agreement; and

(c) a duty to act in good faith under and in relation to the International Franchise Agreement, including a duty to have regard to the legitimate interests of the applicants and not to render the applicants' interests nugatory or worthless.

It was also contended that implementation of the Value Strategy would involve unconscionable conduct in contravention of s 21 of the Australian Consumer Law, being Sch 2 to the *Competition and Consumer Act 2010* (Cth) (the **Australian Consumer Law**).

117 In her Honour's reasons, Jagot J noted that, according to the Franchisees, the Value Strategy if introduced would have a detrimental or even catastrophic impact upon the profitability of their individual businesses. The evidence included the assertion that the implementation of the Value Strategy would substantially reduce the profits of the

Franchisees and cause serious loss and damage extending to loss of the entire business. The applicants relied upon an expert report from Mr Potter. (This was not as extensive as Mr Potter's report before the Court at the trial of the present proceeding.) Justice Jagot noted that Mr Potter's analysis did not take into account the impact on sales which might be occasioned by any competitive response by Pizza Hut's competitors. Her Honour noted that Mr Potter considered that a competitive response was likely. Indeed, during the course of the hearing, her Honour was provided with evidence that Domino's proposed imminently to extend its existing $4.95 offer from two days per week to every day of the week.

118 Mr Smith's evidence before Jagot J was to the effect that the Value Strategy was developed in response to the downward trend in financial performance of the Franchisees and increased indebtedness of Franchisees to Adco. He said that by December 2013, senior executives of Yum had decided that something needed to be done urgently to turn the business around, arrest the decline in value of the Pizza Hut brand in Australia and help the Franchisees achieve higher sales and profitability.

119 The evidence before Jagot J was that Yum considered the ACT Test to have been a success and that Mr Smith and other senior executives had formed the view that the results observed in the ACT would be stronger were the Value Strategy to be applied nationally with marketing support. Justice Jagot noted that on 3 June 2014, a meeting of Yum senior managers had taken place during which various issues, including concerns as to the viability of the pricing in the Value Strategy, were discussed, but that a decision was taken at the conclusion of the meeting, in principle, to proceed with the Value Strategy. This was affirmed as a final decision the following day.

120 Justice Jagot referred in her judgment to the various briefings offered and given to the Franchisees in April and May 2014. Her Honour noted, at [18], Mr Smith's evidence that the briefings provided were "necessarily at a high level because [Mr Smith] was concerned that there was a risk that the information would enter the public domain at an

early stage, providing Pizza Hut's competitors with an opportunity to respond to the strategy more quickly than otherwise would have been the case". Her Honour considered this to have been a legitimate concern.

121 Justice Jagot stated (at [26]):

> There is no evidence whatsoever to suggest that Yum believed it was acting solely in its own financial interest at the expense of and without any proper or reasonable regard for the interests of the franchisees in maintaining the profitability and asset values of their franchise businesses. To the contrary, the evidence adduced by the respondent consistently discloses that Yum believed, and continues to believe, that it is acting in the financial interests of all parties to the franchise agreement and with a proper view to maintaining the profitability of the franchisees' businesses as a whole.

122 Justice Jagot formed the view that the essence of the Franchisees' complaints was that: Yum had not co-operated in good faith because it did not consult with the Franchisees about the modelling that it undertook to evaluate the Value Strategy; and the modelling undertaken by Yum was not objectively reasonable because, among other things, Yum did not factor in a rate of return to Franchisees on their capital investment. Justice Jagot concluded that if there was a serious question to be tried on either of these bases, it was an extremely weak one. Her Honour noted that the dispute was not as to the existence of implied duties on the part of Yum but whether Yum had breached any of those duties or provisions.

123 At the interlocutory injunction hearing, Yum conceded that the duty to co-operate was a duty concerned with the advancement of the interests of the business, but noted that this did not grant to the Franchisees a right of veto over pricing strategy in the face of the International Franchise Agreement and its express provision as to the setting of a maximum price. Justice Jagot accepted that the process that Yum had adopted showed that Yum had taken great care in developing the Value Strategy. Her Honour stated (at [29]) that it was not a strategy that was invented capriciously or arbitrarily. Further, the process involved giving the Franchisees notice, from as early as February 2014, of the perceived need for change, and the tests that had been conducted overseas, in Western

Australia and the ACT. Justice Jagot said (at [30]):

> With respect to whether Yum's modelling was objectively reasonable, as I have said above, I accept Yum's submission that, even if the modelling is wrong, it does not necessarily mean that Yum breached of any of the implied terms or engaged in unconscionable conduct. The question is whether Yum failed to act reasonably and honestly in the performance of duties and exercise of any rights, powers or discretions under the franchise agreement, or failed to act in good faith towards the franchisees under and in relation to the franchise agreement, not whether it adopted modelling with which the franchisees agreed.

124 Justice Jagot concluded that there were serious questions to be tried but they seemed to be extremely weak. Taking into account the balance of convenience, her Honour was not satisfied that the interlocutory injunction should be granted and did not grant it.

Domino's response to the Value Strategy (24 June 2014)

125 On 24 June 2014, the same day as the interlocutory injunction hearing, Domino's publicly announced its price changes. While Domino's matched the $4.95 price point for *take-away* pizzas, it did not match the price reduction on *delivered* Classics pizzas by Pizza Hut. Domino's did not reduce its $11.95 pizzas to match the price change to the Legends/Favourites pizzas by Pizza Hut and did not delete any of its premium range pizzas. Domino's included two new pizzas in a range called "Value Plus" at $7.95. The primary judge found (at [419]) that once Domino's announced the launch of its own strategy based on a $4.95 pizza every day, Yum "really had no choice but to follow with the already planned VS".

Yum's email to Franchisees on 25 June 2014

126 On 25 June 2015, Mr Smith sent an email to the Franchisees stating, in part: "I'm writing to reaffirm that our value launch initiative will take effect 1 July 2014."

Implementation of the Value Strategy (1 July 2014)

127 On 1 June 2014, the Value Strategy took effect, with the prices and ranges

changing as set out in [97] above. These prices were subsequently changed. For example, on 14 August 2014, Yum increased the delivered price for Classics from $4.95 to $8.95 and the delivered price for Favourites from $8.50 to $11.95. Her Honour found (at [398]) that decisions made subsequent to the launch of the Value Strategy "were clearly attempts to recover from the losses being experienced by the Franchisees", while also offering comparable prices and ranges to Domino's.

THE APPLICANT'S CASE AT TRIAL

128 DPL's case at trial was substantially broader than the case advanced by the appellant on appeal. Among other things, DPL advanced a case at trial that Yum wanted to implement the Value Strategy for a purpose other than assisting the Australian Pizza Hut businesses; in particular, DPL contended that Yum was acting under direction from Yum US, which wanted the Value Strategy implemented in Australia for its own reasons, not concerned with Australian profitability (see Reasons, [389]). Her Honour held (at [390]) that DPL had "not established such a conspiracy". The appellant does not pursue such a case on appeal.

129 DPL's pleaded case at trial was set out in its amended statement of claim (the **statement of claim**). For present purposes it is relevant to note the contractual duties or obligations alleged by DPL.

130 In [7] of the statement of claim, it was alleged that Yum owed the following implied duties to DPL and to each of the Franchisees:

(a) a duty to co-operate with Franchisees to achieve the objects of the International Franchise Agreement; and

(b) a duty to comply with standards of conduct that are reasonable having regard to the interests of the parties to the International Franchise Agreement.

These duties were said to arise at law.

131 In [8] of the statement of claim, it was alleged (among other things) that the "object of the IFA is to generate profits for [DPL] and each Franchisee through the development of its business at each Outlet … using the Pizza Hut System and marks in accordance with the IFA, and simultaneously to generate fees payable by way of Continuing Fees to Yum as a percentage of revenues generated by that business".

132 It was alleged, in [9] of the statement of claim, that on the proper construction of clause C1 of the International Franchise Agreement (or alternatively as an implied term of the agreement):

> … any maximum retail prices of the Approved Products set and advised by Yum under that clause must be sufficient to allow, or alternatively must be reasonably capable of allowing, [DPL] and each Franchisee to charge prices at the Outlet, to which the IFA relates:
>
> a. to make profits from operating that Outlet (**Make Profits**), and/or
>
> b. in the case of any change to the maximum retail prices:
>
> i. to make profits at the same level from operating that Outlet as applied prior to the change (**Maintain Profits**); and/or
>
> ii. to increase its profits from operating that Outlet after that change takes effect (**Increase Profits**).

133 In [9A] of the statement of claim, various definitions or explanations were provided for the purposes of the term alleged in [9]. In [9B] and [9C], alternative constructions or implied terms were alleged.

134 The statement of claim dealt with duty of care at [10]-[11A] and the Australian Consumer Law at [12]. The pleading then dealt with: the advice to Franchisees regarding the Value Strategy; the Yum Model; Domino's response; and other matters. From [16] onwards, the statement of claim alleged: breach of clause C1; negligence; breach of implied terms; and unconscionable conduct in contravention of the Australian Consumer Law.

THE JUDGMENT BELOW

135 The primary judge set out the factual background and submissions on the facts in Part 5 of the Reasons, the submissions as to the application of legal principles in Part 7 of the Reasons, and the more general submissions of the parties in Part 8 of the Reasons. Her Honour's consideration of the issues was contained in Part 9 of the Reasons. It is necessary to refer to this section of the Reasons in some detail in order to provide context for the issues raised by the appeal.

136 In relation to the object and terms of the International Franchise Agreement, her Honour stated at [353]-[361] of the Reasons:

> 353 There are a number of aspects of the IFA that are particularly relevant to an understanding of the object of the contract and the obligations of the parties:
>
> Ÿ It was a standard form contract.
>
> Ÿ It was to apply to different Franchisees in different parts of Australia.
>
> Ÿ Those Franchisees would have different capabilities and experience and different access to and provision of capital to be put into the operation of the franchise.
>
> Ÿ The nature of the franchise was the making and supply of pizzas. Accordingly, there had to be a uniform standard to be applied to the products and product range had to be uniform.
>
> Ÿ Yum, as franchisor, was responsible for the design of the uniform system and its maintenance as well as the choice of the products, which could be changed or withdrawn at any time.
>
> Ÿ Yum was also responsible for the advertising of the Pizza Hut products and promotions, although the Franchisees were free to engage in their own advertising as well, with Yum's written approval.
>
> Ÿ Yum had the right to fix a maximum price for the products.
>
> Ÿ The Franchisees could not claim against Yum if advertising or a promotion was unsuccessful.
>
> Ÿ After the exercise of a single option to renew for a second 10 year term, any transfer or sale of the franchise had to be approved by Yum.
>
> Ÿ The Franchisees were obliged to use best endeavours to develop the business the subject of the IFA and to increase the revenues to Yum.
>
> Ÿ The Franchisees acknowledged that establishment and operation of the business will involve financial risk, which is not guaranteed or underwritten by Yum.
>
> 354 **It can be accepted that the object of the IFA was to enable the**

Franchisees reasonably to have the opportunity to run a profitable operation. That was in the interests of the Franchisees and of Yum, not least because Yum received 6% of the gross receipts received by the Franchisees. However, that does not mean that it was an object of the IFA that the maximum price fixed for each pizza in the product line had to be profitable to each Franchisee, especially if the overall sales mix was profitable. There is no such obligation express or implied in the contract, which has as its object the totality of the business of the franchise. As DPL itself states, the object of the IFA is to generate profits for DPL and each Franchisee, that is for the overall business, not for each pizza. Further, it is not necessary and is by no means necessary commercially. It can well be the case that a particular pizza is priced at a low dollar value to entice customers to buy from Pizza Hut, where the Franchisees can make a profit from the other items, such as other pizzas and sides, that are purchased. Further, a good offer may encourage customers to return to Pizza Hut as it is seen to be good value for money compared to competitors. In any event, under the IFA the Franchisees expressly do not have a claim against Yum if a promotion is not successful.

355 There is no dispute that the obligations of cooperation, good faith and fidelity to the bargain must be taken into account in construing the rights under the IFA. The exercise of discretions granted under the IFA must take the obligations into account. However, the express provisions of the IFA are also relevant, as is the nature of that agreement. It is a standard form contract applicable to each Franchisee operating a Pizza Hut franchise in different geographical locations in Australia in a uniform manner. That uniformity extends to products and maximum prices and to the applicability of national marketing and promotion campaigns. The IFA expressly provides, realistically, that Yum is not liable if such marketing campaigns do not result in increased profits. An obligation to ensure profits for each Franchisee with respect to a given promotion, including the setting of a maximum price which is particularly low, is not only inconsistent with clause 6.2, it is also commercially unrealistic in the context of different Franchisees with different factors ensuring profit.

356 Such an implied obligation or term should not be imported by law, it is inconsistent with express conditions of the IFA and it does not comply with the tests in *Codelfa*. The implied term advanced by DPL would also involve rewriting the bargain between the franchisor and Franchisees. It could not be implied into DPL's contract alone, as that would negate the nature of the bargain, being a uniform system. It fails the *Codelfa* test for the above reasons, not least its commercial unreality.

357 There is an express provision in the IFA to the effect that Yum does not guarantee a profit to the Franchisees. The profit would depend not only on the operation of the System but also on the ability of the individual Franchisees and, if the cost of capital were to be included as DPL submits, the cost of capital that each Franchisee had invested in the franchise. The implication of such a guarantee is inconsistent with this provision and with the IFA as a whole.

358 Further, with respect to DPL's claim to a right to profits on sale or

transfer, the IFA makes such an event, after the exercise of the 10 year option, subject to Yum's approval.

359 **It can be accepted that in setting a maximum price, that price should be sufficient to be one that is reasonably capable of allowing DPL and the other Franchisees to make profits.** However, first, profit is not limited to one particular pizza but relates to the operation of a franchise as a whole. Secondly, DPL asserts that the resulting profit must be at the same level and take account of all overheads and costs to the individual Franchisee. Such detail was not known to Yum. In any event, the Yum Model was implemented on Yum's belief that it would help to reverse declining profits and result in increased profits for the Franchisees.

360 **That is not to say that Yum's discretion under the IFA was unfettered. It had to be exercised in good faith and reasonably and with reasonable cause**. Yum had an obligation to act honestly and with fidelity to the bargain but that does not mean that Yum was under a strict liability to make decisions that only resulted in success and more profits for the Franchisees. That does not mean that a decision made in good faith and on reasonable grounds that proved to be unsuccessful in realising profits, and in fact realised losses, renders Yum liable for any Franchisee losses. It also does not mean that hindsight is applied to a decision, importing facts known subsequently but not at the time that the decision is made.

361 Further, the IFA granted certain powers to Yum expressly. It is not for the Court to rewrite those contractual powers, although care should be taken to ensure that the powers are not abused by being exercised unreasonably, particularly where the power was conferred only on one party without a balancing power conferred on the other. However, it is also important to recall that the essence of the IFA is the Pizza Hut franchise, which operates under the System developed and maintained by Yum. It is this franchise and Yum's oversight that is the foundation of the IFA and the right to participate in the System is the bargain purchased by the Franchisees, albeit in the expectation objectively ascertained that Yum would act reasonably in the parties' joint interests with a view to achieving commercial success.

(Emphasis added.)

137 Her Honour dealt with Yum's decision to set the relevant maximum prices at [362]-[370]. In particular, in this section of the Reasons, her Honour stated:

363 As to the way in which the dollar price was derived, it is clear that **Yum and, in particular Mr Houston, carefully considered the appropriate maximum price taking into account that it was part of an overall strategy**. Mr Houston weighed an alternative price that was slightly higher and made a choice. **DPL has not established that Mr Houston acted dishonestly or in bad faith or with reckless disregard for the Franchisees**. He clearly agonised over the decision and based it,

ultimately, on his views of the ACT Test and the workings of the Yum Model which had, in his belief, been demonstrated to a number of Franchisees. DPL submits in a variety of ways that the implementation of the VS was at the direction of, or for the purposes of, Yum US and not for the purposes of or the benefit of the Pizza Hut business in Australia. That case has not been made out. Mr Houston made the decision for implementation in Australia based on the Yum Model and taking into account the ACT Test and, to some extent, the results in New Zealand.

…

365 There is no suggestion or any evidence that any of the Franchisees, who saw the Yum Model prior to Mr Houston's decision and were able to provide input into its parameters to project their own position, made any complaint about the choice of parameters, including the provision for labour hours. Mr Houston was of the view that the VS, which included the maximum prices determined by Yum, was capable of delivering the same profits to the Franchisees, as the Yum Model showed that with the predicted 34.5% uplift, the profits would be the same. He was also of the view that the VS would also serve to reverse the downward trend in market share that he believed existed. …

…

368 It may be that Mr Houston was naïve, or that he did not himself delve into the Yum Model or the ACT Test results to conduct or consider an appropriate analysis. He may have demonstrated poor business judgment, particularly with the benefit of hindsight. However, **that does not equate to a lack of fidelity to the bargain or to unconscionable behaviour**. Mr Houston, as the decision maker, took advice from his executives and from Yum US who had experience with a similar strategy; he balanced the factors, including the knowledge that the Franchisees were against the VS. **He made what he considered to be the best decision from the point of view of Yum and the future profitability of the Franchisees**. He and the Yum executives, rightly or wrongly but reasonably, believed in a first mover advantage. He also clearly believed, again **rightly or wrongly but reasonably, that once Domino's offered an everyday $4.95 pizza, Pizza Hut had no choice but to implement the VS** that was ready to go.

…

370 As events occurred, the outcome of the VS as planned is not known. Domino's intervention took away the first mover advantage that was an assumed factor in the Yum Model and in the deliberations of Yum executives that resulted in the decision to implement the VS. As a result, was also a reduction in the planned-for amount for advertising that would have come from the Franchisees.

(Emphasis added.)

138 Her Honour considered the ACT Test, the Yum Model and the first mover

advantage at [371]-[401] of the Reasons. In relation to these matters, her Honour stated in part:

> 371 Various criticisms can be made of the Yum Model. Matters such as reliance on the New Zealand data, the adoption of the New Zealand benchmark and the labour hours imported into the Yum Model to achieve the 34.5% price lift have been shown by DPL to be validly subject to comment and some criticism. However, these are not the only questions to be asked and it is clear that Mr Sinha and Mr Houston believed that the Yum Model was valid and reliable, as a model.
>
> 372 The ACT Test was just that: a test. There is no doubt that the ACT Test can be evaluated in different ways. It had the advantage of involving a number of stores which should have assisted extrapolation to a national average store but those stores were also in a limited and somewhat special geographical area. The use of the ACT as the test location and the use of the ACT stores is not in dispute. However, the parties disagree as to the proper analysis of the results. Yum drew conclusions from the results of all of the stores; DPL concluded that only the Erindale store should have been used to calculate the input of labour hours into the Yum Model.
>
> …
>
> 374 It would seem that choices were made by Yum to include and reject data obtained during the ACT Test for the purposes of drawing conclusions as to profitability. DPL has not established that Ms Broad deliberately engineered the results to obtain a false picture of profitability. Ms Broad provided an explanation of decisions that she made and accepted that some data had not been included. While there may be criticisms of her reasons for including some data and not including other data, her decisions, such as which weekly periods to include, have not been shown to be unreasonable or to invalidate her conclusions.
>
> 375 Yum also defended its position that the advertising budget provided for the ACT franchisee did not render those results inappropriate to be replicated nationally. While there may be differences of opinion as to the making of predictions, Yum provided an explanation for its view at the time and DPL did not provide evidence to support its theory. DPL has not established that the correct method would have been to take the marketing budget for the ACT Test and just apply it nationally. A key issue was whether the 4% additional LSM should have been included. I am not satisfied that it was inappropriate to exclude it at the time that the calculations were made. Ms Broad did not include the complete 1.8% of LSM and only used 1.5% as a cut-off mark. Ms Broad stated that the reason that she provided for extra marketing was because it was part of overall marketing activity being produced by Ms Syed's team and her understanding was that Yum would not need to replicate all such cost when the marketing strategy was extended to a national level. Had she done so, it could have altered the profit and loss of the ACT franchisee. However, I am not satisfied that this decision was made with some

ulterior motive or without reason. There are clearly other factors that would need to be taken into account when assessing this issue, such as those raised by Yum, for example the difference in "reach" of different Franchisees. In the formulation of the VS, there was provision for extra marketing, although the relativities with Domino's were not established. Intervening events, such as Domino's prior market entry and the failure to get Adco approval and Franchisee marketing contributions make it impossible to conclude that the failure was due to the VS itself.

…

378 I am not satisfied that DPL has established that only the Erindale store should have formed the basis of a model of the national average store or that Yum was in error in using all of the stores the subject of the ACT Test for the purposes of the Yum Model. It did not lack reason to utilise the ACT Test to examine the strategy over a range of stores in a geographical area, so as better to have an average of stores for the characterisation of a national average store for a model of the effect of a strategy.

379 DPL does not agree that the 13 hours provided for in the Yum Model was a reasonable estimation of variable labour hours which would be required to provide for a 34.5% uplift in transactions. That estimate was made by Mr Sinha. He gave a detailed explanation of his reasoning. That explanation was not shown to be unreasonable, nor did DPL show that the decision was made in bad faith or recklessly. DPL's case rests upon an allocation for labour hours greatly in excess of Mr Sinha's estimate, which was based on his reasoning in section 5.4.4 above. DPL has not demonstrated an error of the order of magnitude it advances. Mr Sinha's estimate was based on Mr Sinha's own experience, including as to the time taken to make a pizza, the use of labour, labour availability in a store across the week and information available to him from New Zealand and the ACT Test. It may have been lacking in detailed analytics, including interrogating the data to separate driver hours, as carried out by Mr Potter, but Mr Sinha is not a qualified accountant; he worked his way up in the Pizza Hut business. He explained his own experience as to the time taken to make a pizza and as to the information that he received from the ACT franchisee as to the use of delivery drivers.

380 Mr Sinha was adamant that the provision in the Yum Model of 13 additional hours was reasonable. Mr Sinha gave evidence as to his reliance on the New Zealand data and what he drew from the ACT Test but he also drew on his own experience, including as a pizza maker in a Pizza Hut franchise. Mr Sinha explained that he did not in fact rely on the New Zealand data alone for determining the labour hours for the Yum Model. Even accepting that he used the incorrect data point from New Zealand by way of reference, he did not simply insert that into the model but also relied on the ACT Test results to establish the correct data point. Whether or not 5.6 was the appropriate New Zealand benchmark for measuring labour efficiency during the ACT Test, New Zealand merely represented an imperfect comparator. For example, RBNZ was the master franchisee in New Zealand and Pizza Hut has a greater market

share in New Zealand than does Domino's. The fact is that Mr Sinha says that he used it merely as a comparator and relied on the ACT Test results and his own experience and that evidence was not shaken.

…

383 Minds may differ as to whether Mr Sinha with practical experience or an accountant with theoretical qualifications would be better placed to determine such parameters for the Yum Model based on the information available. That may, in turn, also be affected by the use of the Yum Model. Mr Sinha and Mr Potter came to different conclusions, in part based on different use of the ACT Test data and on the breadth of those data compared to the data for one store. It is not uncommon for different people with different perspectives to have different opinions as to the parameters, efficacy and applicability of a model. Even accepting that Erindale represented what should happen with a well-run store, that does not mean that only Erindale data should apply to a model of the national average store and other data rejected. It was not shown to be unreasonable or negligent to use Mr Sinha rather than an accountant. DPL has not shown that Mr Sinha's reasoning was not open or that his determination was unreasonable or made in bad faith or recklessly. Rather, Mr Sinha was satisfied that his calculation of 13 additional labour hours was reasonable and provided an appropriate input into the Yum Model.

384 The fact that criticisms can be made, for example that Mr Sinha used the New Zealand benchmark rather than the underlying New Zealand data, may mean that he should have analysed those data more carefully but it does not mean that the benchmark represented an unreasonable figure. Ultimately, Mr Sinha formed the view that it was consistent with his experience and with the ACT data.

385 Similarly, DPL recognises that a business can be modelled in different ways. It prefers Mr Potter's analysis and use of a product/cost model. Yum does not accept the validity of Mr Potter's analysis nor of the assumptions that he has made. Yum prefers Mr Sinha's and Mr Gower's and a break even model. Each party challenges the assumptions made in the opposing model. However, DPL has not shown that the Yum Model was developed unreasonably or in bad faith or negligently.

386 Mr Potter has shown that additional labour hours can reasonably be calculated from the data to be significantly higher than 13 hours, especially if it can be accepted that, as demonstrated in the ACT Test and as explained by Mr Sinha, different stores adopt different usage and record of payment of drivers, some of whom also work in the store and are then paid on an hourly basis, whereas other stores use drivers that only do a guaranteed number of deliveries. However, this demonstrates that different models could reasonably have been created, especially where decisions are made by former pizza store managers and compared to those of analytical accountants. It does not necessarily follow that Mr Sinha's Yum Model was flawed or, if so, he should have appreciated that fact.

> 387 Mr Potter calculated that a $4.95 Classics pizza price point was unprofitable but failed to take into account other aspects of the VS, including other pizza range price points and subsequent changes to the prices following the implementation of the VS. His calculations are challenged by Yum and Yum submits, in effect, that in any event Mr Potter's conclusions are not connected to the Yum Model, the design of which does not correlate with Mr Potter's methodology. In any event, Yum's evidence is to the effect that Mr Houston and ultimately Ms Broad, as well as Mr Smith, were of the view that the VS as a whole, including the $4.95 Classics pizza and the uplift in sales, would increase Franchisee profits.
>
> 388 DPL contends that the Yum executives knew or ought to have appreciated that the VS as a whole would be unprofitable or loss-making for the Franchisees. Nevertheless, DPL's submission that the implicit bargain is that Yum will not impose '*an unprofitable price*' that will negatively impact on the Franchisees' profitability is somewhat simplistic. DPL emphasises the price of a Classics pizza, being the pizza for which the $4.95 maximum price was imposed. However, the point of the VS was to bring about a 34.5% sales uplift, not just by the sale of more Classics pizzas but also by the increased sale of other pizzas in the range and side orders, together with increased deliveries for which there was a delivery charge. DPL's focus on the $4.95 price point of the Classics range has not taken into account the variation in the mix of pizzas before and after the implementation of the VS. Before the implementation of the VS, the Classics range was one of four ranges of pizza in the mix; following the implementation, the mix was reduced to two ranges. There were also sides and delivery fees to be considered as part of the total sales. The $4.95 Classics pizza could be viewed as a "loss leader" to bring about a substantial increase in overall sales and hence increased profitability for both Yum and the Franchisees.

The primary judge's reference, in [388], to a 34.5% "sales" uplift would appear to be a slip, as the Yum Model referred to a 34.5% uplift in *transactions*. Similarly, the reference in [371] to a 34.5% "price" lift should be to a 34.5% *transaction* lift.

139 Her Honour dealt next with DPL's case that Yum was acting under direction from Yum US, which wanted the Value Strategy implemented in Australia for its own reasons, not concerned with Australian profitability. Her Honour rejected that case at [389]-[393].

140 Her Honour also stated as follows in relation to the decision to implement the Value Strategy:

> 396 I reject the submission that Mr Houston's decision to implement the VS was made in bad faith, or on the orders of Yum US, or without

consideration of the Franchisees, or simply to increase Yum's share of increased turnover irrespective of whether it was accompanied by increased profit or loss by the Franchisees. As viewed today, Mr Houston may not have been totally adequate for his role in steering Yum through the task of deciding on the best and most accurate Yum Model and whether or not to implement the VS. However, he was the CEO of the company, entrusted with oversight of those matters and he sought to fulfil his tasks to the best of his ability. In making the decisions, he was entitled to delegate appropriate matters, such as the creation of the Yum Model to other Yum employees. For example, Mr Sinha was, to Mr Houston's knowledge, sufficiently experienced to help to create the model. The fact that Mr Sinha had no accounting qualifications did not seem to affect Mr Houston's faith that, as an experienced Pizza Hut employee who had risen to National Operations Manager of Yum, he could rely on Mr Sinha to provide appropriate input into the Yum Model.

397 It would only be speculation to consider what would have happened had the Franchisees not applied for an injunction, or to consider what would have happened had Domino's not entered the market. Each event occurred and had consequences. I accept Yum's evidence that it also perceived that the first mover advantage was a relevant and important factor in the launch of the VS.

…

399 The evidence is that Domino's did respond to the new pizza prices in the ACT by advertising in the ACT, including on television. Mr Creedy warned Mr Houston not to rely on the lack of response in New Zealand and that Domino's would respond in Australia. I do not accept Yum's evidence that it was unaware of Domino's response in the ACT, although that matter may not have been reported to the Yum leadership team or Mr Houston. It is not credible that a responsible marketing manager who was aware of the importance of the major competitor's response would fail to monitor the media broadly upon the implementation of the ACT Test. In any event, when Mediacom advised Ms Syed of the Domino's advertisement on 13 June 2014, she did advise the Yum leadership team. This was in advance of the launch of the VS and by then Yum knew that Domino's was likely to respond immediately to the VS and that it did respond in the ACT. However, this does not mean that Yum failed to believe in the first mover advantage, although Yum appreciated, or should have appreciated, that the first mover advantage would be short-lived or diminished.

…

403 Justice Jagot recognised the applicable principles and applied them to the evidence before her. Her Honour accepted the potential financial impact on the Franchisees and, as set out above, concluded that DPL's case, that Yum had not cooperated with the Franchisees in the advancement of the interests of the business in good faith about the modelling and that the modelling was not objectively reasonable by not providing, inter alia, for a return on capital, was a weak one. Her Honour concluded that Yum

had shown great care in developing the VS and that it was not a strategy that was developed capriciously or arbitrarily. Her Honour also observed that even if the modelling was wrong, it did not necessarily mean that Yum had breached any implied term or engaged in unconscionable conduct. Further, her Honour said, adopting modelling with which the Franchisees did not agree did not constitute unreasonable behaviour on the part of Yum or a failure to act in good faith towards the Franchisees in relation to the IFA.

404 With respect, I adopt Jagot J's comments and findings. Despite the much greater amount of evidence than was available to her Honour, those comments and findings remain apposite.

…

408 DPL has not established that Mr Houston made his decision in bad faith or negligently. The evidence shows that Mr Houston agonised over the decision whether to implement, knowing full well that the Franchisees opposed this course but knowing also that Domino's, the market leader, had launched a similar initiative. Mr Houston, rightly or wrongly, believed in the Yum Model and that the results of the ACT Test were sufficiently positive to support a national implementation. He was also acutely conscious of the fact that Yum's data demonstrated that Pizza Hut had lost, and was losing, market share.

…

410 Subsequent analysis shows that Mr Houston's faith in the Yum Model may have been misplaced. It was apparent during his evidence that he did believe that it was valid and that it could be used as a model for the national stores. A business judgment that, with hindsight, can be criticised when it was a judgment made in accordance with the powers and discretions in the IFA, in good faith and pursuant to a genuine attempt to benefit both Yum and the Franchisees by boosting sales and profits, is not a breach of the IFA.

…

415 DPL argues that Yum should have appreciated that Domino's would respond immediately and with television advertising, although this did not happen in New Zealand. Mr Creedy advised Mr Houston that he did not believe that Domino's would take the same approach as in New Zealand and the evidence is that Domino's did commence advertising in the ACT. It is not clear that Mr Houston appreciated the fact of Domino's early response, including on television, in the ACT. I accept that Ms Syed did not inform the Yum leadership team of that fact until 13 June 2014, some 5 weeks after the advertisement commenced. Ms Syed's evidence as to why she did not know of that response was unconvincing. On the other hand, there is no reason why she would have delayed in informing the Yum leadership team of such information. It was her job to know such things and to monitor them. However, she failed in doing so.

416 In any event, Mr Houston did not rely on any delay by Domino's in

responding. He appreciated that it would react to Yum's national launch. He also appreciated that the timing of such a response was important because he was acutely aware of the Franchisees' ability to maintain the price point without the increased market share that the first mover advantage and better perceived value was assumed to bring. In that regard, it cannot be said that Mr Houston disregarded the views and position of the Franchisees. He acknowledged those views in the Help! email of 3 June 2014. It was a factor that he took into account in coming to a business decision that he hoped would bring increased profitability to all or at least 90% of Franchisees. He did not blindly accept the ACT Test data but those data and the New Zealand results represented the available data. He appreciated that Domino's would react and quickly, although at that time he did not know of the television advertising by Domino's in the ACT or, of course, that Domino's would launch first.

…

418 As it turned out, it was Domino's that had the first mover advantage, with Yum following close behind with the VS. The evidence does not establish that Yum should have appreciated this likely circumstance prior to the interlocutory proceedings, but it was aware of it before it implemented the VS.

419 I accept that once Domino's announced its own launch of a strategy based on a $4.95 pizza every day, **Yum really had no choice but to follow with the already planned VS**. DPL says that this may constitute a fresh decision. If it does, that only assists Yum in my view. Even if there was some hesitation prior to this point, I accept that it was reasonable for Yum to decide, for the reasons that Yum advances, that if it did not match the Domino's lower price point, it would lose even more market share to Domino's.

…

421 Mr Houston's evidence was clear and logical: once Domino's implemented its own price changes, he felt that Yum had no alternative but to implement the VS, without the first mover advantage. Again, this was a business decision that had to be made immediately. Even though the price points were not identical to those of Domino's, the VS was ready to be implemented and Mr Houston was of the view that Pizza Hut had to respond to its competitor.

422 This was particularly the case as Mr Houston was firmly of the opinion that Pizza Hut was experiencing a general decline in sales and transactions and in market share to Domino's. …

423 It follows that Mr Houston's decision for Yum was not unconscionable, nor unreasonable, nor irrational as DPL alleges. Nor has DPL established that Yum breached the duty of care that it owed the Franchisees as alleged. Yum was not under a duty to ensure profitability of each franchise, nor under a duty to ensure that profits were maintained or increased, as alleged by DPL. In any event, Yum believed that the VS would result in increased profitability for the Franchisees and that it

would arrest the decline in market share. The suggestion by DPL that Yum was obliged only to engage in promotions that were successful is inconsistent with the IFA.

424 As to DPL's assertion that the modelling was conducted negligently and that properly conducted testing and modelling would have indicated a loss of profits, this is answered above with respect to the different approaches to modelling and consideration of the alleged breach of contract. Further, the VS was Yum's idea and an example of one of the responsibilities of Yum as encompassed in the IFA and as to which the Franchisees agreed. It also makes commercial sense for the franchisor of a uniform national system to be responsible for national strategies such as the VS. Yum developed the Yum Model, tested it in the ACT and discussed it with the Franchisees. This then provided information to Yum in order to make a decision as to whether to implement the VS.

425 Yum relies on the contractual, commercial bargain embodied in the IFA which recognises the different position of franchisor and Franchisee and to which the Franchisees agreed. Yum's submissions as to its obligations under the IFA and the exercise of the powers there granted in accordance with its obligations in contract and in law should be accepted.

(Emphasis added.)

141 At [436], the primary judge concluded that it followed that she had accepted Yum's submissions generally and that the applicant "[had] not established that Yum was in breach of its obligations in relation to the implementation of the VS". Accordingly, the primary judge stated, the applicant's application should be dismissed with costs.

142 The primary judge also noted, at [436], that the application had set out a series of specific questions for the purpose of s 33H(1)(c) of the *Federal Court of Australia Act*. It was noted that the parties' submissions had not specifically addressed the questions set out in the application and that some of the questions were not capable of a straightforward answer. The primary judge indicated, at [437], that she would give the parties an opportunity to consider whether any orders with respect to the questions in the application needed to be addressed further, beyond the consideration of those questions in the Reasons.

143 The primary judge considered the issue of loss and damage in Part 11 of the Reasons. It is not necessary for present purposes to refer in any detail to this section of

the Reasons.

144 On 8 March 2016, the primary judge made orders that:

> 3. The amended application be dismissed, subject to ruling on the report from Dr Lindgren in respect of the reference ordered on 23 December 2015.
>
> 4. DPL pay Yum's costs of and incidental to this proceeding.

The report of Dr Lindgren, referred to in the first order set out above, related to a confidentiality issue and is not relevant for present purposes.

145 Annexure A to the orders of 8 March 2016 set out answers to the common questions. Annexure A was in the following terms:

> 1. What is the proper construction of clause C1 of the International Franchise Agreement (**IFA**) in relation to the power of the respondent to advise the maximum prices for the Approved Products?
>
> *(a) In setting maximum prices under clause C1, the prices should be sufficient to be reasonably capable of allowing franchisees to make profits, where profits are measured at the level of the franchise operation as a whole and on an EBITDA basis.*
>
> *(b) Yum's discretion under Clause C1 is not unfettered. It had to be exercised in good faith and reasonably and with reasonable cause. However it does not impose a strict liability on Yum to make decisions that only result in success and more profits for franchisees. Yum is not in breach of clause C1 if it makes a decision about maximum prices in good faith and on reasonable grounds that prove not to realise profits or in fact realise losses.*
>
> *See [359], [360].*
>
> 1A. Whether there is any implied term that the power exercised by the respondent under clause C1 of the IFA must have regard to (a) the effect on franchisee profitability; and/or (b) the costs incurred by a franchisee in selling the Approved Product; and if so, what is that implied term(s)?
>
> *(a) It can be accepted that the object of the franchise IFA was to enable franchisees reasonably to have the opportunity to run a profitable operation, but that does not mean that it was an object of the IFA that the maximum price for each pizza in the product line had to be profitable to each franchisee, especially if the overall sales mix was profitable. There is no such obligation express or implied in the contract, which has as its object the totality of the business of the franchise.*

(b) *The implied obligations of cooperation, good faith and fidelity to the bargain must be taken into account in construing the rights under the IFA. However the express provisions of the IFA are also relevant, as is the nature of the agreement. There is no implied term that Yum must ensure profits for each franchisee in general or with respect to a given promotion (including the setting of maximum prices for each pizza).*

See [354], [355], [356].

2. Whether the maximum prices advised by the respondent to the Pizza Hut franchisees (**Franchisees**) on 10 June 2014 (**Advice**), and affirmed on 25 June 2014, of $4.95 for the "Classics" pizza range and $8.50 for the "Legends" pizza range to apply from 1 July 2014 (**Reduced Prices**) and/or the Reduced Price Strategy set out in paragraph 13(c) of the Amended Statement of Claim (**ASOC**) (**RPS**) were in breach of clause C1 of the IFA and/or the implied term(s) referred to in paragraph 1A above?

No.

2A. As at 10 June 2014, what was a reasonable measure of the following costs in respect of a Pizza Hut Outlet prior to and after the implementation of the Reduced Prices and/or RPS: operating costs, overheads, depreciation and cost of capital?

Given the findings of fact and law, this question does not fall to be determined.

2C. For the period from 1 July 2014, whether the sale price of $4.95 for "Classics" pizzas was less than the reasonable cost for Franchisees of selling those pizzas?

Given the findings of fact and law, this question does not fall to be determined.

3. Whether Yum had any power to set the Minimum Delivery Order Value, the Delivery Surcharge and/or the Pick Up Minimum set by Yum as set out in paragraph 15 of the ASOC under the IFA?

Given the findings of fact and law, this question does not fall to be determined.

4. Whether the respondent owed a duty of care to the Franchisees in relation to any conduct or decision made by it in performing services and/or in the exercise of its powers as franchisor of the Pizza Hut system under the IFAs so that the Franchisees could operate their respective Pizza Hut Outlets to make, maintain or increase profits; and if so, how is that duty defined?

The Court did not find any such duty. See [425].

4A. In respect of a financial model designed and developed by the respondent of the effect of the Reduced Prices and/or RPS in about May or June 2014 (**Yum Model**):

(a) What was the purpose of the Yum Model and how was it used by the respondent?

The purpose of the Yum Model, which was an EBITDA Model, was for the model to be used as a tool, based on certain assumptions and parameters, to assist Yum in ascertaining the level of increase in transactions required for the "National Average" store to retain the same EBITDA level of profitability after the introduction of the Value Strategy. See [394]-[395].

(b) Whether the respondent failed to exercise reasonable skill and care in designing and developing the Yum Model; and if so, what were those failures?

No.

4B. Whether a competitive response by Domino's Pizza Enterprises Limited (**Domino's**) to the Reduced Prices and the RPS was a reasonably foreseeable consequence and/or was foreseen by the respondent as the probable and likely consequence of the Advice given by the respondent on 10 June 2014 and/or the implementation of the Reduced Prices and/or RPS?

As a result of the answer to 2 and 4 above, this question does not fall to be determined. [426].

5. Whether the respondent exercised due skill and care in designing and implementing the Reduced Prices and/or the Reduced Price Strategy for implementation on 1 July 2014?

As a result of the answer to 4 above, this question does not fall to be determined.

6. Whether the respondent owed duties to each of the Franchisees under the respective IFAs entered into between the respondent and that Franchisee for the operation of a Pizza Hut outlet to act cooperatively and/or reasonably having regard to the interests of the Franchisees under the IFA and the objects of the IFA?

See 1A above.

7. Whether the respondent in setting the Reduced Prices and/or implementing the RPS on 1 July 2014:

(a) Failed to act cooperatively with the Franchisees to achieve the objects of their respective IFAs?

No.

(b) Failed to comply with standards of conduct that are or were reasonable having regard to the interests of the Franchisees to achieve the objects of their respective IFAs?

No.

7A. Whether it was known or ought to have been known by Yum that the

introduction of the Reduced Prices and/or RPS would be to the financial advantage of Yum and the financial disadvantage of the Franchisees, and/or whether Yum was indifferent to the legitimate financial interests of the Franchisees in operating their respective Outlets in deciding to implement the Reduced Prices and/or RPS on 1 July 2014?

Having regard to the Court's finding that the General Manager, Mr Houston, made what he considered to be the best decision from the point of view of Yum and the future profitability of the Franchisees, this question does not fall to be determined. [368].

8. Whether the respondent has acted unconscionably within the meaning of s.21 of the *Australian Consumer Law* in setting the Reduced Prices and/or implementing the RPS on 1 July 2014?

   No.

8A. On what date did Yum make its decision(s) to implement the Reduced Prices and/or RPS in Australia, and what role did any approval or support from Yum's US parent companies play in the making of that decision(s)?

   Yum's decision to implement the Value Strategy, as devised, was made on 4 June 2014. The evidence demonstrates that the decision to implement the Strategy was made by Mr Houston. Mr Houston had discussions with executives of Yum US and took account of their views and sought alignment with the US Franchise Policy Committee to ensure that Yum received funding for the strategy, but he did not act under their direction. See [390], [402].

   The Value Strategy that was in fact implemented was not the same Value Strategy that was devised. Once Domino's launched, Mr Houston had to decide whether Pizza Hut could afford not to implement the available strategy, or whether the best business decision was to implement it and to try to avoid Domino's being the only one with this offer in the market. See [400], [401].

9. Whether, by reason of 1 to 8A above, the respondent is liable to Franchises for damages?

   No.

10. Whether damages payable to Franchisees can be assessed by calculating:

    (a) Loss of profit from not being able to sell the Approved Products at the prices prevailing as at 30 June 2014, or such other prices in excess of the Reduced Prices as would have prevailed if Yum had not implemented the Reduced Prices and/or the RPS?

        As a result of the answer to 9 above, this question does not fall to be determined.

    (b) Loss of profit since 1 July 2014 on sales foregone as a consequence of the Other Prices stipulated by Yum, in particular

in relation to delivery sales?

As a result of the answer to 9 above, this question does not fall to be determined.

THE APPEAL

146 The appellant's notice of appeal contains the following grounds (omitting those grounds and parts of grounds that are not pressed):

1. In relation to the test applied by the primary judge for the purpose of determining whether the Respondent (**Yum**) had breached the contractual duties owed by it to the group members (**Franchisees**) in respect of the Value Strategy (**VS**) (cf. Judgment sections 7.2, 8.3), the primary judge:

   (a) Erred in:

   (i) Directing herself to a test whether the representative party below (**DPL**) had established that Mr Houston, the General Manager of Yum, acted dishonestly or in bad faith or with reckless disregard for the Franchisees, and finding that Yum had not done so but had acted with great care and had developed a strategy that was not capricious or arbitrary (at [363], [403]);

   (ii) Finding that Mr Houston, for the purpose of the test applied by the primary judge:

   (A) May have been naïve or did not himself delve into the Yum Model or the ACT Test results to conduct or consider an appropriate analysis, and may have demonstrated poor business judgment with the benefit of hindsight; and

   (B) May not have been totally adequate for his role in relation to deciding on the best and most accurate Yum Model or the decision whether or not to implement the VS;

   but that nevertheless he had acted to the best of his ability with faith in the other Yum employees who reported to him (at [368], [396]);

   (b) Ought to have:

   (i) Directed herself to an objective test whether the grounds on which Yum acted were reasonable, and found that no such grounds existed (see Grounds 3 to 10 below) on or before the decision to implement the VS was made on or prior to 4 June 2014 (Judgment section 5.5.2), or was announced to Franchisees on 10 June 2014, or was

confirmed on 23 June 2014;

(ii) Found that the failure of the VS was not a matter which became obvious only with the benefit of hindsight, but that the VS was destined to fail on the objective evidence available to Yum and Mr Houston prior to the decision being made to implement the VS (cf. [370]), had a reasonable, proper and competent analysis been undertaken of that evidence by Yum at the time;

(iii) Found that no reasonable person making a rational and proper business judgment would have made the decision made by Yum and Mr Houston to implement the VS, on the objective evidence available to Yum at the relevant time(s), properly analysed, and also having due and proper regard to the financial interests of the Franchisees.

2. In circumstances where the primary judge accepted that the VS implemented by Yum, caused loss and damage to the Franchisees (at [279], [347]), and that Yum had contractual obligations to the Franchisees to set maximum prices that should be sufficient to be reasonably capable of allowing Franchisees to make profits (at [359]) and to act in good faith and on reasonable grounds and/or with reasonable cause (at [360]), the primary judge:

(a) Erred in concluding that Yum did not breach those contractual obligations and that the decision of Mr Houston and Yum to implement the VS did not equate to a lack of fidelity to the bargain or to unconscionable behaviour (at [368]);

(b) Ought to have found that:

(i) Yum breached each of its contractual obligations for the reasons set out in Grounds 1 and 3 to 10 below;

(ii) The breach of those obligations was causative of the loss and damage suffered by the Franchisees as a result of the implementation of the VS.

3. In relation to the Yum Model (Judgment sections 5.4, 5.5.1, 9.3), the primary judge:

(a) Erred in finding that:

(i) Mr Houston made the decision to implement the VS based, at least in part, on the Yum Model, that rightly or wrongly he believed in the Yum Model and, by implication, that he and Yum were justified in so doing (at [363], [408]);

(ii) Despite the valid criticisms and comments made by DPL of the Yum Model, Mr Houston and Mr Sinha believed the Yum Model was valid and reliable (at [371]);

(iii) Mr Sinha's explanation for including 13 additional labour hours in the Yum Model in respect of the VS was not shown to be not open, unreasonable, or made in bad faith or recklessly (at [379], [383]), that it had not been established that only the Erindale store data should have been used, or that Mr Sinha erred by a significant order of magnitude in the labour hour calculations (at [378], [379]);

(b) Ought to have found that:

(i) The version of the Yum Model on which Yum sought to rely at the hearing had not been finalised prior to 23 June 2014, and to the extent it existed at any particular time, it did not provide any, or any proper or reasonable, basis for the making of a decision to implement the VS;

(ii) Mr Houston and Yum had no reasonable basis to conclude that the labour costs in any of the versions of the Yum Model were reasonable or accurate, or were anything other than a "balancing item" used in the various drafts of the Yum Models produced in May and June 2014;

(iii) There was no reasonable or proper basis for Yum or Mr Sinha to include only 13 additional labour hours in the Yum Model in respect of the VS, and such an assumption could not be justified on any reasonable or proper analysis of the ACT Test or data obtained by Mr Sinha from New Zealand or otherwise;

(iv) A reasonable and proper assumption for the additional labour hours to be included in the Yum Model in respect of the VS was substantially greater than 13 hours, having regard to the information available to Yum at the time;

(v) Neither Yum nor Mr Houston undertook any, or any reasonable or proper, analysis of the costs to the Franchisees of selling the "Classics" pizzas at $4.95, in the context of the transactions predicted to occur as a result of the implementation of the VS, or the losses that the Franchisees would suffer thereby;

(vi) …

(vii) Ought not to have drawn any inference favourable to Yum in relation to the preparation of the Yum Model having regard to Yum's failure to call Mr Purcell or Ms Vasco who were responsible for preparing and updating drafts of the Model, contrary to the rule in *Jones v Dunkel* (1959) 101 CLR 298 (cf. [382]).

4. In relation to the demonstration of the Yum Model to the Franchisees (Judgment section 5.6), the primary judge:

(a) Erred in finding that:

(i) Implicitly, the Yum Model had been shown to Franchisees prior to the making of the decision by Mr Houston to implement the VS (at [365]);

(ii) Mr Houston based his decision, in part upon his belief that the Yum Model had been demonstrated to a number of Franchisees (at [365]);

(b) Ought to have found that the Yum Model was not shown to any Franchisee prior to the making of [the decision by] Mr Houston to implement the VS, and that Mr Houston had no reasonable basis to hold any such belief, by reason that:

(i) no completed Yum Model was in existence as at 10 June 2014, when the decision was announced to Franchisees, or at any time prior to 23 June 2014 when the Yum Model was completed;

(ii) Yum relied upon information available to it from its own data and the ACT Test to prepare a model of store-level profitability in the Yum Model, and did not otherwise seek input from Franchisees to assist in this process, either at all or prior to 10 June 2014 (cf. at [367], [369]).

5. In relation to the ACT Test (Judgment section 5.3, 9.3), the primary judge:

(a) Erred in finding that:

(i) Mr Houston made the decision to implement the VS having regard to the results of the ACT Test, that rightly or wrongly he believed that the results of the ACT Test were sufficiently positive to support the VS and, by implication, that he and Yum were justified in so doing (at [363], [408]);

(ii) The decisions made by Ms Broad in analysing the ACT Test results were not unreasonable, did not invalidate her conclusions as to profitability and were not made for an ulterior motive or without reason (at [374], [375]);

(b) Ought to have found that:

(i) There was no reasonable or proper basis for Yum or Mr Houston to have concluded that the ACT Test was a success, or provided any, or any reasonable or proper, basis for the making of a decision to implement the VS;

(ii) The ACT Test was a failure on any reasonable or proper

analysis, and in particular that:

(1) A reduced pricing strategy of the type included in the VS would produce very significant losses for franchisees;

(2) There was no first mover advantage to be gained by the introduction of a reduced pricing strategy of the type included in the VS;

(3) By reason of the use of a reduced pricing strategy in the ACT, Domino's were well prepared to respond immediately to any reduced price strategy implemented nationally by Pizza Hut;

(4) …

(iii) The analysis by Ms Broad that the ACT Test led to an improvement in franchisee profitability was not a reasonable or proper analysis of the ACT Test data, and in particular:

(1) Contravened generally accepted accounting principles requiring the matching of expenses and revenues;

(2) Involved the making of purported comparisons of data from different time periods which were not truly comparable;

(3) …

(4) …

6. In relation to the New Zealand results, the primary judge:

(a) Erred in finding that Mr Houston made the decision to implement the VS having regard to the results in New Zealand to some extent, and, by implication, that he or Yum were justified in so doing (at [363]);

(b) Ought to have found that the New Zealand pricing strategy was not comparable to the VS, and there was no reasonable or proper basis for any conclusions to be drawn by Yum or Mr Houston to the effect that the introduction of the VS could be supported by reference to the New Zealand experience, having regard to:

(i) the differences in the pricing structures implemented in New Zealand compared to the VS;

(ii) the differences in cost structures, and in particular labour cost structures and efficiencies, between the Australian and New Zealand markets;

(iii) the differences in the market dynamics as between Pizza

Hut and Domino's in New Zealand and Australia;

(c) Ought also to have found that it would have been reasonable and proper for Mr Houston and Yum to have taken heed of the warning given to Yum by the CEO of the New Zealand franchisee on 20 May 2014 that Domino's would activate an aggressive counter-strategy to any reduced prices by Pizza Hut in Australia (cf. [154]).

7. In relation to the Domino's and any first mover advantage (Judgment section 5.9, 9.5), the primary judge:

(a) Erred in finding that:

(i) Mr Houston and the Yum Executives, rightly or wrongly, but reasonably believed in a first mover advantage, and that the VS was a strategy where Franchisees would have the advantage of being first to market with a new price structure (at [366], [368], [397]);

(ii) Mr Houston rightly or wrongly, but reasonably, believed that once Domino's offered an everyday $4.95 pizza that Pizza Hut had no choice but to implement the VS, and it was not established that he made the decision in bad faith or negligently (at [368], [407], [419]);

(b) Ought to have found that:

(i) There was never any, or any reasonable, prospect of Pizza Hut obtaining the benefit of any or any sustainable first-mover advantage, as acknowledged in evidence by Yum's Marketing Executive, Ms Syed;

(ii) By at least 4 June 2014 and at all relevant times thereafter, an immediate reaction from Domino's was expected by Mr Houston and Yum, and that Mr Houston and Yum were aware by at least 3 June 2014 that Franchisees did not have the ability to sustain a $4.95 price point for more than a few weeks or to "weather the storm";

(iii) Yum's decision to introduce the VS was the cause of Domino's decision and announcement that it would be extending its $4.95 price point to certain take-away pizzas every day of the week (cf [417]);

(iv) On and after 24 June 2014, Domino's announcement that it would be extending its $4.95 price point to certain take-away pizzas every day of the week, did not provide any or any reasonable justification for the implementation of the VS;

(v) The VS was not a reasonable or proper response by Yum as franchisor to the decline in market share of Pizza Hut

compared to Domino’s.

8. …

9. In relation to the expected financial impact of the VS (Judgment Section 9.2, 9.3), the primary judge:

   (a) Erred in finding that:

      (i) The decision to implement the VS involved careful consideration by Mr Houston of the appropriate maximum price, and that he made what he considered to be the best decision from the point of view of Yum and the future profitability of the Franchisees (at [363], [387]);

      (ii) Yum believed that the VS would help reverse declining profits and result in increased profits for the Franchisees, and was an opportunity for Franchisees to achieve a short term or longer term benefit (at [359]);

      (iii) The relevant question to be considered in relation to the cost of production of a pizza was limited to the cost of ingredients only, and that the experts had so agreed (cf [311], [367]);

      (iv) The $4.95 “Classics” pizza could be viewed as a loss leader to bring about a substantial increase in overall sales and increased profitability for both Yum and the Franchisees (at [388]);

   (b) Ought to have found that:

      (i) Yum did not undertake any modelling or sensitivity analysis of its pricing strategies, beyond the incomplete modelling of the VS which was based on a sub $5 price for “Classics” pizzas;

      (ii) Mr Houston and Yum had no reasonable or proper basis for forming a view that the VS was in the interests of the Franchisees, or the best decision for the future profitability of the Franchisees, and that Mr Houston and Yum had misconceived the contractual obligation to set maximum prices under the IFA;

      (iii) …

      (iv) …

      (v) There was no reasonable or proper basis upon which the $4.95 price for “Classics” pizzas could be justified as a “loss leader” or as a promotional price, and neither Yum nor the Yum Model sought to provide justification for the VS and the use of the $4.95 price for “Classics” on

such a basis.

10. In relation to the date of the decision (Judgment section 9.4), the primary judge:

    (a) Erred in finding that the evidence tended to support Yum's contention that the decision to implement the VS was made in June 2014 (at [402]);

    (b) Ought to have found that Yum … made a final decision to proceed with the implementation of the VS on 4 June 2014.

11. In relation to the claim in negligence (Judgment sections 7.3, 8.4), the primary judge:

    (a) Failed to find and ought to have found that Yum owed each of the Franchisees a duty of care in relation to any conduct or decision by Yum in providing services as franchisor of the System and in the exercise of its powers under the IFA (cf. [250]), having regard to the finding at [361] that Yum's oversight of the System is the foundation of the individual contracts entered into between Yum and each Franchisee;

    (b) Erred in finding that DPL had not established that Yum had breached the duty of care alleged (at [423]), and ought to have found for the reasons set out in Grounds 1 and 3 to 10 above that:

        (i) Yum breached its duty of care in the design, and by the implementation, of the VS, including in the design and implementation of the Yum Model;

        (ii) The breach of the duty of care by Yum was causative of the loss suffered by the Franchisees as a result of the implementation of the VS.

12. In relation to the unconscionable conduct claim (Judgment sections 7.4, 8.5), the primary judge:

    (a) Erred in directing herself to a test whether DPL had established a conspiracy that Yum was acting under direction from Yum US who wanted the VS implemented in Australia for its own reasons, not concerned with Australian profitability (at [389]-[390]);

    (b) Failed to find and ought to have found, having regard to Grounds 1 to 11 above, that:

        (i) The Franchisees were vulnerable to exploitation by Yum and the use of its contractual powers to advance its own interests at the expense of the Franchisees;

        (ii) The implementation of the VS by Yum involved the exercise of contractual powers disproportionately in favour of its own interests at the expense of the

Franchisees and represented a fundamental change to the bargain embodied in the IFA;

(iii) The decision to implement the VS was, in all the circumstances, so unreasonable that no reasonable decision maker could have made it on a reasonable and proper analysis of the evidence available to Yum, unaffected by confirmation or other bias;

(iv) Yum's conduct in all the circumstances was contrary to the modern Australian commercial, business or trade conscience (cf [272]), by reason of which Yum contravened s.21 of the *Australian Consumer Law* by its implementation of the VS, and the Franchisees suffered loss and damage by reason of that contravention.

13. In relation to the state of mind of the officers of Yum who participated in the decision-making process that led to the implementation of the VS (Judgment sections 6.2, 9.6):

(a) the primary judge erred in directing herself to the question whether the Yum witnesses had acted to the best of their ability, and believed in the accuracy and honesty of the reasons for their conduct and the decisions made by them (at [429]-[431], [433])

(b) ought to have found, in respect of each of Mr Houston, Ms Broad and Mr Sinha, that:

(i) None of them gave reasonable and proper consideration to the evidence available to Yum in their respective areas of responsibility as set out in Grounds 1 to 12 above …;

(ii) …

14. In relation to the question of loss and damage (Judgment section 11), the primary judge failed to find and ought to have found that the methodology for the assessment of damages proposed by Mr Potter was an appropriate and proper methodology for the assessment of the loss and damage suffered by Franchisees arising from the implementation of the VS, and the breaches of duty by Yum addressed in this Notice of Appeal and the Common Questions.

147 By its notice of contention, Yum contends that the judgment below should be affirmed on the following grounds (other than those relied upon by the primary judge):

1. To the extent that the primary judge found as a matter of construction that, in setting maximum prices under clause C1 of the International Franchise Agreement (**IFA**), the prices should be reasonably capable of allowing franchisees to make profits when measured at the level of the franchise operation as a whole and on an EBITDA basis (Judgment at [359], [360]), the primary judge should alternatively have held that the Respondent (Yum) was under no obligation with respect to setting

maximum prices other than to exercise that power in good faith and for a proper purpose.

2. To the extent that the primary judge found the object of the franchise IFA was to enable franchisees reasonably to have the opportunity to run a profitable operation (Judgment at [354]), the primary judge should alternatively have found that the object of the IFA was to permit the Franchisee to participate in a unique and valuable franchise system devised by Yum and its affiliates for the preparation, marketing and sale of pizzas and other food products.

3. To the extent that the primary judge found an implied term of reasonableness formed part of the contract between Yum and its Franchisees (Judgment at [360]), the primary judge should alternatively have held that there was no such implied term.

148 It will be convenient to consider the issues raised by the notice of appeal and the notice of contention under the following headings:

(a) whether Yum breached the contractual duties it owed to Franchisees;

(b) whether Yum is liable to the Franchisees in negligence; and

(c) whether Yum's conduct was unconscionable within the meaning of the relevant statutory provisions.

WHETHER YUM BREACHED THE CONTRACTUAL DUTIES IT OWED TO FRANCHISEES

Good faith and reasonableness (grounds 1-10, 13)

149 These grounds raise legal and factual challenges arising from the primary judge's finding that Yum's discretionary power to fix maximum prices was subject to an (implied) obligation that it be exercised honestly and reasonably and with reasonable cause (Reasons, [360]). This we take to be referring to what is more usually described as a duty or obligation of good faith and reasonableness. Synonymous phrases such as 'good faith and fidelity to the bargain' and 'good faith and fair dealing' are also employed: see, eg, *Burger King Corporation v Hungry Jack's Pty Ltd* (2001) 69 NSWLR 558 at [146], citing *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234 at 268; *Paciocco v Australia and New Zealand Banking Group*

Ltd (2015) 236 FCR 199 at [288]; *Macquarie International Health Clinic Pty Ltd v Sydney South West Area Health Service* (2010) 15 BPR 28,563; [2010] NSWCA 268 at [12]-[13]. See also, generally, *Marmax Investments Pty Ltd v RPR Maintenance Pty Ltd* (2015) 237 FCR 534 at [142]-[150].

150 In this section of our reasons, we deal only with the legal challenge. The appellant's various challenges to the primary judge's factual findings are dealt with in the sections that follow.

151 The appellant's legal challenge is directed to an alleged error in relation to the test to be applied in determining whether Yum had breached its implied obligation to the Franchisees to exercise its discretionary contractual power to fix maximum prices in good faith and reasonably. The error was asserted to be the application of a subjective, rather than an objective, test to the question of reasonableness.

152 The appellant does not challenge the finding of the primary judge that Yum, by its decision- maker, Mr Houston, acted honestly when he set the maximum prices. Indeed, by paragraph 3 of the orders of 10 March 2017, the appellant is constrained from raising any issue on the appeal as to the subjective state of mind of any officer of Yum.

153 Rather, the appellant contends that the maximum prices set and the methodology applied in constructing each of those prices, when considered objectively, were each unreasonable and thus in breach of an implied term of the International Franchise Agreement that the discretionary power to set maximum prices was required to be exercised reasonably.

154 It is not readily apparent from ground 1 of the notice of appeal whether the appellant contends this to be a distinct implied obligation, separate from any consideration of an implied obligation of good faith or, alternatively, as requiring distinct consideration within the so-called duty of good faith *and* reasonableness, or, indeed,

whether it contends both.

155 The position became somewhat more focused in argument. The appellant's starting point, in oral submissions, was founded on the conclusions of the primary judge at Reasons, [360], which we set out again for ease of reference:

> That is not to say that Yum's discretion under the IFA was unfettered. It had to be exercised in good faith and reasonably and with reasonable cause. Yum had an obligation to act honestly and with fidelity to the bargain but that does not mean that Yum was under a strict liability to make decisions that only resulted in success and more profits for the Franchisees. That does not mean that a decision made in good faith and on reasonable grounds that proved to be unsuccessful in realising profits, and in fact realised losses, renders Yum liable for any Franchisee losses. It also does not mean that hindsight is applied to a decision, importing facts known subsequently but not at the time that the decision is made.

156 The appellant does not challenge the conclusion of the primary judge that the discretionary power was subject to an implied term of good faith and reasonableness in its exercise. Yum, too, acknowledges that there is an implied obligation of good faith (T162) but puts in issue that consideration of the obligation requires an objective consideration of the exercise of the power, at least in the terms contended for by the appellant. Moreover, it submits that reasonableness is an aspect of the obligation of good faith and challenges the appellant's submission that there is an independent duty to exercise a contractual power objectively reasonably (T160).

157 The appellant's submission was that the primary judge's finding of honesty and absence of bad faith, which is beyond challenge, does not dispose of the matter because the element of reasonableness, within the composite phrase 'good faith and reasonableness' adverted to by the primary judge, requires separate consideration upon an objective basis.

158 Such objective reasonableness, the appellant contended in its oral submissions, involves a consideration, objectively, of whether the maximum prices set were arrived at by Yum exercising reasonable care and skill as well as whether, objectively, the prices set

were reasonable.

159 The findings by the primary judge were that:

(a) Yum had not acted dishonestly;

(b) its conduct did not equate to a lack of fidelity to the bargain, nor did it constitute unconscionable behaviour; and

(c) there was no question of bad faith, dishonesty, capricious, arbitrary or unconscionable conduct attending Yum's decision.

160 The primary judge did not treat reasonableness, in the broad, as a distinct and separate implied contractual obligation attending the discretionary power to fix a maximum price.

161 However, in her Reasons at [359], the primary judge stated that it could be accepted that, in setting the maximum price, it "should be sufficient to be one that is reasonably capable of allowing [the Franchisees] to make profits".

162 Yum, in its notice of contention, challenges this conclusion, if indeed it is the conclusion of the primary judge when considered in its context. We will return to this in due course.

163 Her Honour's approach in the context of examining the composite obligation expressed as one of 'good faith and reasonableness' was to consider the reasonableness of Yum's conduct by evaluating Mr Houston's conduct in arriving at his decision to fix the maximum price.

164 In our opinion, no error has been demonstrated in this approach. Moreover, we would reject the appellant's submission that the notion of reasonableness within the composite phrase is to be viewed distinctly from the obligation of good faith. The obligation, expressed as one of good faith and reasonableness, is to be considered in a

composite and interrelated sense. To the extent that consideration is given to whether a party's conduct is reasonable or not, it is directed to the primary component of the obligation, namely of good faith. Reasonableness is not to be approached in a case such as this as akin to a tortious duty to exercise due care and skill or to produce a reasonable outcome. Rather it goes to the quality of the conduct, here in exercising the price setting power, to discern whether it was capricious, dishonest, unconscionable, arbitrary or the product of a motive which was antithetical to the object of the contractual power. Conduct attended by any of those qualities could never be said to be in good faith. Consideration of the relevant conduct within these confines informs the question whether or not the power has been exercised in good faith.

165 The converse, in our opinion, also follows. Where, as in this case, there is a finding of good faith (or, specifically, a finding that there was an absence of bad faith: in effect, not having demonstrated that there was a lack of good faith) attaching to the exercise of the contractual power, then that exercise must necessarily also have been reasonable. In any event, as we will explain, the primary judge considered both limbs of the good faith and reasonableness obligation and concluded that the conduct of Yum was reasonable, albeit expressed in the negative as conduct that was not capricious or arbitrary or unreasonable ([403]-[404]) and also found that dishonesty and bad faith had not been established (at [363]).

166 We have come to these conclusions for the following reasons.

167 We do not propose to embark upon any general discussion as to when, and by what legal method, the law will imply an obligation of good faith and reasonableness in a contract. Nor do we propose to discuss whether such an obligation is to be implied or arises as a matter of construction of a given contract. It is sufficient that in this case it was common ground that under the International Franchise Agreement such an obligation arose, although on Yum's part, reasonableness is to be seen in the confined way we have described earlier. However, it is necessary to consider what such an obligation involves.

168 In *Renard Constructions*, Priestley J (Handley JA agreeing) concluded that a particular contractual power, including a power to vary or cancel the contract, was required to be exercised reasonably.

169 His Honour observed (at 263) that the kind of reasonableness to which he was referring had much in common with the notions of good faith found in many European civil law systems, and all states of the United States of America, as necessarily implied in many kinds of contract.

170 In the course of his Honour's decision he referred to a lecture given by Steyn J at Oxford University entitled "The Role of Good Faith and Fair Dealing in Contract Law: A Hair-Shirt Philosophy?" (1991) 6 *Denning Law Journal* 131. Here, we see one kind of a composite expression of the obligation. There then follows discussion of the Latin maxim '*ex aequo et bono*' which may be translated roughly as 'with fairness and good faith', another composite phrase. It is unnecessary to delve more deeply into the etymology of the phrase but Priestley JA makes the point that in ordinary English usage there has been a constant association between the words 'fair and reasonable'. His Honour continued by observing that there is a close association of ideas between the terms unreasonableness, lack of good faith and unconscionability. Moreover, his Honour noted that whilst each expression is not co-extensive there was no doubt that in many of their uses there is a great deal of overlap in their content, particularly as related to the kind of situation in the case before the Court.

171 The New South Wales Court of Appeal in *Burger King* considered the existence and scope of an implied obligation of good faith and reasonableness in a commercial contract. The Court concluded that such an obligation attached to a particular provision (cl 4.1) in the Development Agreement made between the parties.

172 In its consideration of what was meant by the expression 'good faith and reasonableness', the Court at [169]-[170] adopted, with apparent approval, what

Priestley JA had observed in *Renard Constructions* as to the association between the concepts of good faith and reasonableness, which we have set out above.

173 The Court then referred, again with apparent approval, to observations of the trial judge:

> 171 Rolfe J observed that in *Alcatel Australia* [*Ltd v Scarcella* (1998) 44 NSWLR 349], Sheller JA (at 369) appeared to equate the notions of "reasonableness" and "good faith". Whilst Sheller JA did not say that in terms, his review of the case law and academic and extra-judicial writings on the topic, clearly support the proposition. In addition to his references to *Renard Constructions*, Sheller JA (at 367) referred to the statement of Sir Anthony Mason in his 1993 Cambridge Lecture, that it was probable that the concept of good faith "embraced no less than three related notions":
>
> "(1) an obligation on the parties to co-operate in achieving the contractual objects (loyalty to the promise itself);
>
> (2) compliance with honest standards of conduct; and
>
> (3) compliance with standards of [conduct] which are reasonable having regard to the interests of the parties."
>
> 172 In *Garry Rogers Motors (Aust)* [*Pty Ltd v Subaru (Aust) Pty Ltd* [1999] ATPR 41-703; [1999] FCA 903], Finkelstein J considered (at 43,014) that such a term imposed an obligation on a party "not to act capriciously". He pointed out, however, that such a term will not restrict a party acting so as to promote its own "legitimate interests". As his Honour explained, "provided the party exercising the power acts reasonably in all the circumstances the duty to act fairly and in good faith will ordinarily be satisfied".

174 It may generally be noted, as Allsop CJ observed in *Paciocco* at [287], that good faith in the performance of contracts is a good example of the presence of values in the common law. As to the nature of those values, it is again useful to have recourse to Allsop CJ in *Paciocco*, where, at [292], his Honour observed that good faith is rooted in honest and reasonable fair dealing, citing *Macquarie International Health Clinic* at [12]-[13]. Kiefel J (as her Honour then was) in *Commonwealth Bank of Australia v Barker* (2014) 253 CLR 169 at [104] similarly observed that fairness in dealings as between contracting parties may be understood as an aspect of a duty of good faith. Sir Anthony Mason in his Cambridge Lecture stated that he used "good faith" mainly in the sense of

loyalty to the promise itself and as excluding “bad faith behaviour”.

175 Thus viewed, reasonableness is referable to the standard of a party’s conduct or behaviour in relation to the performance of a contractual obligation or exercise of a contractual power. It may, for example, include consideration of a party’s real intention or purpose in exercising a contractual power. It calls into consideration, for example, whether that conduct is or is not honest, capricious, arbitrary or for an extraneous purpose. This last example may be no more than saying that the conduct was capricious or arbitrary, as Sheller JA observed in *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349 at 368. In any event, such an adaption was central to the case mounted by DPL at trial, to which we refer in more detail below. Such characterisations of conduct are ascertained upon the evidence in a particular case and in the context of the particular contract, having regard to acceptable norms of commercial conduct.

176 There is considerable support for the characterisation of reasonableness that we have outlined in the Australian authorities referred to in these reasons.

177 In *Burger King*, the breach of the implied obligation of good faith and reasonableness was by reason of the appellant’s use of its contractual discretion under clause 4.1 for a purpose foreign to that for which it was granted. In that case, what was reasonable was ascertained by reference to the terms of the contract.

178 Importantly, and contrary to the appellant’s alternative submission, it may also be seen that ‘reasonableness’ as an adjunct to an obligation of good faith has never been regarded as a duty to exercise due care and skill or to produce a reasonable outcome.

179 Thus, the expressions within the composite phrase are necessarily and closely related. Consideration of the reasonableness of a party’s conduct will inform the question of whether good faith or its absence has been brought to the performance of the contractual obligation or exercise of the power.

180 Thus, Giles JA in *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15 at [192] observed that "[r]easonableness can be seen as part of good faith, and acting in bad faith is hardly reasonable". It would not be possible for a party to be acting in good faith but unreasonably, or to be acting reasonably but with bad faith.

181 The Court of Appeal in Western Australia in *Strzelecki Holdings Pty Ltd v Cable Sands Pty Ltd* (2010) 41 WAR 318 considered an argument that the contractual obligation to negotiate in good faith required the Court to apply an objective concept of reasonableness. Pullin JA rejected this argument. However his Honour's conclusion must be seen in context. At [62], referring to the parties' conduct in relation to the obligation to negotiate in good faith, his Honour said:

> This does not suggest that the content of an offer made in negotiations where the parties must deal with each other in good faith must pass some objective test of reasonableness to be assessed by the courts.

182 His Honour was saying no more, in effect, than that, in a case of that kind, the Courts will not scrutinise the 'content' of an offer made during negotiations in order to determine whether it accords with some objectively reasonable content.

183 However the question whether the 'conduct' of a contracting party is capricious or arbitrary or dishonest or for a purpose foreign to the objective of the contractual obligation or power and thus exhibiting a lack of good faith will instead be adjudicated upon the evidence in a particular case and in the context of the particular contract, having regard to acceptable norms of commercial conduct.

184 As Allsop P said in *Macquarie International Health Clinic* at [15], in the context of an express obligation of good faith, an objective element of reasonableness in fair dealing is appropriate, "taking its place with honesty and fidelity to the bargain in the furtherance of the contractual objects and purposes of the parties, objectively ascertained".

185 His Honour, too, in *Paciocco* at [290] said that it is clear that a normative standard is introduced by good faith but that the legal norm should not be confused with the 'factual question' of its satisfaction and, moreover, that "[t]he contractual and factual context (including the nature of the contract or contextual relationship) is vital to understand what, in any case, is required to be done or not done to satisfy the normative standard".

186 Thus, particular kinds of unreasonable conduct may be found to exist, upon the evidence, as offending acceptable norms. However, this is not the objective assessment of reasonableness for which the appellant contends, namely involving consideration of whether due care and skill has been brought to bear in the exercise of the discretionary power to fix minimum prices and/or the objective reasonableness of the outcome of that exercise. Such an approach forms no part of an obligation or power, express or implied, of good faith and reasonableness in contract law. To the extent that the appellant pleads this formulation of an 'objective' approach to reasonableness, it is incorrect.

187 The primary judge observed at [361] that care needed to be taken to ensure that the discretionary power in question was not abused by being "exercised unreasonably". Her Honour was correctly focused on Yum's conduct in its exercise of the power. Importantly, her Honour considered, on the evidence, whether the conduct of Yum was capricious, arbitrary or dishonest, finding that it was none of these. This, her Honour did, consistently with the principles we have outlined above. The appellant has not demonstrated any error by her Honour in this respect.

188 Indeed, in the interlocutory injunction judgment, Jagot J, in refusing injunctive relief to the applicants, including DPL, found that Yum had shown great care in developing the Value Strategy and that it was not a strategy that was developed capriciously or arbitrarily. The primary judge referred to this at [403], and then at [404] stated:

> With respect, I adopt Jagot J's comments and findings. Despite the much greater amount of evidence than was available to her Honour, those comments and

findings remain apposite.

189 At [363], the primary judge found that "DPL has not established that Mr Houston acted dishonestly or in bad faith".

190 These factual issues went to whether the conduct of Yum was unreasonable within the context of the obligation of good faith and reasonableness. Her Honour concluded emphatically that there was no unreasonable conduct of any kind. It seems to us that she did so upon a consideration of the evidence as a whole and in the context of the particular contract, having regard to acceptable norms of commercial conduct. This, it seems, informed her Honour's conclusion that there was no bad faith. These were conclusions reached which were pivotal to her Honour's conclusion that Yum had not been dishonest and had not exercised the power in bad faith. Whatever honesty or dishonesty might mean in other cases, here such expressions related to the robust case alleged against Yum that it had, for example, manipulated the ACT Test data in order to present a false picture of the profitability of the ACT Test to Franchisees, whilst also concealing the data from Jagot J on the hearing of the interlocutory injunction application.

191 The applicant before the primary judge, it seems, had sought to link such alleged conduct with its further allegation that Yum wanted to implement the Value Strategy for some purpose other than assisting the Australian Pizza Hut business. The alleged purpose was that Yum was acting under direction from Yum US, who wanted the Value Strategy implemented in Australia, for its own reasons, not concerned with Australian profitability. This asserted conspiracy was rejected by the primary judge upon a detailed consideration of the evidence: see the Reasons, [389]-[390] and the following paragraphs.

192 Thus, as we have said, the primary judge resolved the composite and related concepts of good faith and reasonableness upon a consideration of the evidence of the conduct of Yum and of the relevant terms of the International Franchise Agreement as a whole and having regard to the agreement in which the implied obligation of good faith and reasonableness arose. These obligations her Honour assessed holistically, accepting

the interrelated nature of the two concepts of good faith and reasonableness. The appellant has not successfully demonstrated why a different legal test, as outlined above and involving due care and skill, should have been used by her Honour. Thus, neither her Honour's conclusions, nor the test she applied in making findings of fact, demonstrate error. Accordingly, the appeal, to the extent it depends on these questions, must fail.

Notice of contention

193 The respondent in its notice of contention raised the three grounds set out at [147] above.

194 At trial, DPL had pleaded a number of different implied terms. In particular, in the statement of claim at [9] (set out at [132] above), two implied terms were pleaded. The first implied term, broadly, was that any maximum retail price be sufficient to allow the Franchisees to make profits. The second was that any such price must be reasonably capable of allowing the Franchisees to make a profit.

195 The primary judge, in our view, regarded the first of these pleaded implied terms as one requiring that any maximum price set be such as to ensure that the Franchisees would make a profit, but rejected the implication of such a term on the grounds that it failed at least some of the criteria outlined in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266 as applied in *Codelfa Construction Pty Ltd v State Rail Authority (NSW)* (1982) 149 CLR 337. Those criteria required that, to imply a term (*Codelfa* at 347 per Mason J):

> (1) it must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) it must be so obvious that 'it goes without saying'; (4) it must be capable of clear expression; (5) it must not contradict any express term of the contract.

196 This is most clearly seen at Reasons, [355]-[357]. No challenge is made by the appellant to this finding.

197 Rather, Yum in its notice of contention challenges the finding at Reasons, [359] as to the second implied term pleaded where the primary judge stated, in something of a hybrid of the two pleaded implied terms, as follows:

> It can be accepted that in setting a maximum price, that price should be sufficient to be one that is reasonably capable of allowing DPL and the other Franchisees to make profits.

198 It is instructive to refer to the Reasons at [359] where the primary judge, having made the finding as to the implication of this term, continued on from the above statement to note:

> However, first, profit is not limited to one particular pizza but relates to the operation of a franchise as a whole. Secondly, DPL asserts that the resulting profit must be at the same level and take account of all overheads and costs to the individual Franchisee. Such detail was not known to Yum. In any event, the Yum Model was implemented on Yum's belief that it would help to reverse declining profits and result in increased profits for the Franchisees.

199 Having made what appears to be this finding the primary judge then appears to put its efficacy into question. First, the matter of 'profit' is stated to relate to the operation of each franchise as a whole, rather than be a profit limited to one particular pizza. Yet the implied term pleaded at [9] of the statement of claim was referable to any maximum retail price. Secondly, information necessary to ascertain 'profit', namely the overheads and costs of individual Franchisees, was, on her Honour's finding, not known to Yum.

200 Nonetheless, we will proceed on the basis that this is a finding as to the pleaded second implied term.

201 The finding appears to have proceeded from what the primary judge stated earlier at Reasons, [354] that "[i]t can be accepted that the object of the IFA was to enable the Franchisees reasonably to have the opportunity to run a profitable operation". No reasons are given as to why this was the case. Yum also challenges this finding and submits that the object of the International Franchise Agreement was to grant each Franchisee a

licence to participate in a unique and valuable system developed by Yum and its affiliates for the preparation, marketing and sale of pizzas and other food products.

202 We do not find it necessary to determine what was the object of the International Franchise Agreement. However, were we to have done so, we would adopt what the primary judge stated at [361], which Yum accepts, as follows:

> However, it is also important to recall that the essence of the IFA is the Pizza Hut franchise, which operates under the System developed and maintained by Yum. It is this franchise and Yum's oversight that is the foundation of the IFA and the right to participate in the System is the bargain purchased by the Franchisees, albeit in the expectation objectively ascertained that Yum would act reasonably in the parties' joint interests with a view to achieving commercial success.

203 It is sufficient to conclude, as we do, that the object of the International Franchise Agreement was not as the primary judge held it to be. Such a finding, in our opinion, was in error for the reasons which follow.

204 The International Franchise Agreement was a franchise agreement in substantially the same terms with each of the Franchisees. Each Franchisee would have had differing commercial abilities. Their capital and financing arrangements would likely have been diverse. Yum had no control over those factors, nor indeed would have had relevant knowledge as to them. Likewise, neither Yum nor any of its Franchisees could control market conditions. All of these factors combine to influence the profitability of any Franchisee business.

205 Such factors were identified by the primary judge at Reasons, [353]. Moreover, as her Honour also noted, the Franchisees, expressly in the International Franchise Agreement, acknowledged, in the "Franchisee's Representation", that establishment and operation of the business would involve significant financial risk, which was neither guaranteed nor underwritten by Yum.

206 The International Franchise Agreement contains no promise by Yum that profit will be made, or even that there would be an opportunity provided to make a profit.

Indeed, clause 6.2 excludes any liability on Yum's part for losses incurred as a result of any promotion. The setting of the $4.95 price was held to be part of a strategy or a promotion (Reasons, [362]). Thus, not only is it not provided that maximum prices will afford an opportunity to make a profit but actual losses are contemplated and in the event that they transpired no liability fell upon Yum. However, we do not regard it as necessary to our reasoning on this issue to conclude that the setting of the maximum prices was part of a promotion.

207 Self-evidently, both the Franchisees and Yum would subjectively have desired that profits would be made. However such hopes do not translate to a contractual promise.

208 There is no finding in the Reasons as to what "profit" constituted. As Yum submits, "profit" can be an elusive concept, calculable according to a number of different measures, including subjective measures, such as relating to a required return on capital, and over varying periods.

209 The appellant, for its part, submits that "profit" is not an elusive concept. It says that it accepts that the appropriate measure of profit is the Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA) measure of profit used in the Yum Model, which is a method that eliminates financing, tax, interest and other organisational factors affecting a Franchisee from the profit calculation.

210 However that is not the case, as to profit, that was pleaded and run at trial. At statement of claim, [8] it was pleaded relevantly that:

> a. The object of the IFA is to generate profits for the Applicant and each Franchisee …
>
> b. The benefit of the IFA for the Applicant and each Franchisee is … the ability to make and increase profits (after covering operating costs, overheads including depreciation, and cost of capital) from developing the business at each Outlet by the investment of capital, time, skill and labour ...

211 EBITDA, as a method, was pleaded at statement of claim, [8](c) but, in the

context, not of profit, but in relation to capital gain.

212 Moreover, as noted above, DPL pleaded at [9] of the statement of claim, in relation to an implied term, that any maximum price set, relevantly:

> … must be reasonably capable of allowing, the Applicant and each Franchisee to charge prices at the Outlet, to which the IFA relates:
>
> a. to make profits from operating that Outlet (**Make Profits**), and/or
>
> b. in the case of any change to the maximum retail prices:
>
> i. to make profits at the same level from operating that Outlet as applied prior to the change (**Maintain Profits**); and/or
>
> ii. to increase its profits from operating that Outlet after that change takes effect (**Increase Profits**).

213 Then at statement of claim, [9A] it was pleaded that, for the purposes of the term alleged in [9]:

> (a) Profits of an Outlet (**Profits**) mean the excess of sales revenue, net of gst, of that Outlet less the amount of costs applicable to that Outlet, with such costs to be calculated on a reasonable basis (**Outlet Costs**).
>
> (b) Outlet Costs means:
>
> (i) operating costs, being those costs of the type set out in the Yum Model which appears as Exhibit "KS-4" (**Yum Model**) to the affidavit of Kurt Smith sworn on 23 June 2014 in Proceedings NSD 618 of 2014 ("**A&A Proceedings**"), namely costs of food and other ingredients, labour, fixed fees and an allocation of semi-variable and fixed expenses (**Operating Costs**);
>
> (ii) overheads;
>
> (iii) depreciation; and
>
> (iv) cost of capital
>
> applicable to that Outlet, calculated on a reasonable basis.
>
> (c) A reasonable period for the measurement of Profits and Outlet Costs for the purpose of paragraphs 9, 9A(a) and 9A(b) is a 12 month period;
>
> (d) Where a change in maximum retail prices occurs for the purpose of paragraph 9(b), a reasonable period to determine whether it is reasonably likely that there will be a failure to Maintain Profits or Increase Profits is

no longer than 12 weeks;

(e) A franchisee will Maintain Profits at an Outlet for the purpose of paragraph 9(b) if:

(i) The franchisee continues to make at least the same amount of Profits in dollar terms after the change in maximum retail prices as the franchisee was making prior to that change; and

(ii) The franchisee continues to make at least the same margin of sales revenue, net of gst over its Operating Costs (**EBITDA margin**) after the change in maximum retail prices as the franchisee was making prior to that change;

(f) A franchisee will Increase Profits at an Outlet for the purpose of paragraph 9(b) if:

(i) The franchisee makes a higher amount of Profits in dollar terms after the change in maximum retail prices as the franchisee was making prior to that change; and

(ii) The franchisee makes at least the same EBITDA margin after the change in maximum retail prices as the franchisee was making prior to that change.

214 Again it may be seen that depreciation is included, so too are capital costs.

215 Then at statement of claim, [9B]-[9C] DPL pleaded further or alternative implied terms as to the maximum pricing power. Again, there is no reference to EBITDA other than to what is pleaded as the 'EBITDA margin', which is a related but different concept. Rather, the requirement was that the maximum price set comply with one or more of these alternatives in respect of each Outlet.

216 Then at statement of claim, [15A] the following is pleaded to demonstrate, read with [15B] and [16], that the implied term(s) has been breached. We have set it out in full principally to underline the complexity involved, which is germane to whether such a term could ever be implied:

As at 10 June 2014, and/or as at 25 June 2014:

(a) For the purpose of paragraph 9A(b)(i), the reasonable Operating Costs of a Pizza Hut Outlet in Australia, determined on a per week basis:

(i) prior to the implementation of the Reduced Prices and/or

Reduced Price Strategy:

(A) for an Outlet having the sales revenue of the "National Average" Outlet, were the costs stated in the Yum Model for the "National Average" Outlet under the heading "Now";

(B) for each other Outlet of the Applicant and the other Franchisees, were:

(1) "Food Cost" calculated as having the same percentage to the total sales of that Outlet as the Food Cost had to the total sales in the Yum Model for the "National Average" Outlet under the heading "Now" of [redacted]%;

(2) "Labour" cost calculated on the basis of the labour rates used in the "National Average" Labour Model and:

I. Fixed labour hours of 97 hours for Management (including the Franchisee if the Franchisee worked in the Outlet);

II. Variable labour hours for the Crew Members determined such that total labour hours of Management in (I) above and Crew Members, excluding drivers, was 3.8 transactions per hour, being the rate applied in the "National Average" Labour Model;

III. Driver costs are calculated on the daily blended driver rate per delivery as set out in the "National Average Labour Model".

(3) "Fixed Fees" of 12.9% as set out in the Yum Model for the "National Average" Outlet;

(4) "Semi Variables" costs calculated on the same basis as set out in Yum Model for the "National Average Outlet, namely:

I. A fixed component which was the same amount as the amount allowed for each Semi-Variable Cost for the "National Average" Outlet;

II. A variable component which is calculated as having the same percentage to the total sales of that

Outlet as the same item of "Semi Variable" costs had to the total sales in the Yum Model for the "National Average" Outlet under the heading "Now";

(5) "Fixed Expenses" in the same amount as the amount allowed for Fixed Expenses in the Yum Model for the "National Average" Outlet.

(ii) after the implementation of the Reduced Prices and/or Reduced Price Strategy, for the Break Even Transaction Level stated in paragraphs 13D and 13E above:

(A) for any Outlet based on a predicted level of transactions and sales revenue for that Outlet:

(1) "Food Cost" calculated as having the same percentage to the total sales of that Outlet as the Food Cost had to the total sales in the Yum Model for the "National Average" Outlet under the heading "Future" of [redacted]%;

(2) "Labour" cost calculated on the basis of the labour rates used in the "National Average" Labour Model and:

I. Fixed labour hours of 97 hours for Management (including the Franchisee if the Franchisee worked in the Outlet);

II. Variable labour hours for the Crew Members determined such that total labour hours of Management in (I) above and Crew Members, excluding drivers, would be 3.89 transactions per hour, being the rate derived from Erindale Outlet during the ACT Test;

III. Driver costs are calculated on the daily blended driver rate per delivery as set out in the "National Average Labour Model".

(3) "Fixed Fees" of 12.9% as set out in the Yum Model for the "National Average" Outlet;

(4) "Semi Variables" costs calculated on the same basis as set out in Yum Model for the "National Average" Outlet, namely:

I. A fixed component which was the same amount as the amount allowed for each

Semi-Variable Cost for the "National Average" Outlet;

II. A variable component which is calculated as having the same percentage to the total sales of that Outlet as the same item of "Semi Variable" costs had to the total sales in the Yum Model for the "National Average" Outlet under the heading "Future";

(5) "Fixed Expenses" in the same amount as the amount allowed for Fixed Expenses in the Yum Model for the "National Average" Outlet.

(b) For the purposes of paragraph 9A(b)(ii), for the Applicant and each other Franchisee which owned between 4-7 Outlets, the reasonable overhead cost is $200,000pa, to be divided equally by the number of Outlets, with a further allowance to be made for Franchisees having more than 8 Outlets for a Training Restaurant General Manager and any additional Area Managers required by Yum.

(c) For the purpose of paragraph 9A(b)(iii), for the Applicant and each other Franchisee, the reasonable cost of depreciation was:

(i) In respect of an Outlet with average weekly sales, net of gst, of $20,000 or more, an amount of $41,500 per annum;

(ii) In respect of all other Outlets, [an] amount of $28,800 per annum.

(d) For the purpose of paragraph 9A(b)(iv), for the Applicant and each other Franchisee:

(i) the reasonable capital value of its or their respective Outlets for the purpose of calculating their respective cost of capital is 4.25 times the EBITDA margin of that Outlet as calculated by the Yum Model under the heading "Now" in accordance with paragraph 15A(a)(i) above;

(ii) the reasonable cost of capital percentage applicable to the amount calculated in (i) above is at least 18%;

(iii) the reasonable cost of capital for its [or] their respective Outlets is the amount determined by applying the rate in (ii) above to the reasonable capital value in (i) above.

(e) By reason of (a) to (d) above, there was no reasonable basis to conclude that the Reduced Prices and/or Reduced Price Strategy

would enable Franchisees to Make Profits, Maintain Profits and/or Increase Profits.

(f) Further or alternatively to (e) above, the only reasonable and proper conclusion to be drawn from (a) to (d) above was that the implementation of the Reduced Prices and/or Reduced Price Strategy would substantially reduce the level of Profits or cause a loss to the Applicant and each other Franchisee from operating its or their respective Outlets.

217 One has but to read statement of claim, [9], [9A]-[9D] and [15A], reflecting an almost byzantine complexity, to immediately conclude that the implied term pleaded, and found by the primary judge, in so far as it depends on ascribing a meaning to making "profits" and related concepts, could never meet the requirements of the *BP Refinery/Codelfa* test. At the very least, such an implied term would self-evidently not be capable of clear expression and its absence would not be fatal to the business efficacy of the International Franchise Agreement.

218 Thus, the extended meanings of "profits" (statement of claim, [9A]), "maximum retail price" ([9B], alternatively [9C]) and "core product" ([9D]) are far from being so obvious that they go without saying. Nor are they necessary to give business efficacy to the International Franchise Agreement. The agreement is effective without such a term being implied. The implied term is not capable of clear expression given the turgid and alternative language employed. The term found contradicts at least clause 6.2 of the International Franchise Agreement.

219 We would for these reasons uphold ground 1 of the notice of contention. The implied term found by the primary judge (at Reasons, [359]) fails to satisfy the *BP Refinery* test adopted in *Codelfa* for the implication of a term.

220 As mentioned, we do not find it necessary to deal with ground 2 of the notice of contention.

221 Ground 3 relies upon the implied term of reasonableness referred to at Reasons,

[360]. This is not a finding of an independent term but rather part of an implied term of good faith and reasonableness which we earlier considered.

The appellant's factual contentions (grounds 1-10, 13)

222 By grounds 1-10 and 13 of the notice of appeal, the appellant challenges a number of factual findings made by the primary judge and contends that other factual findings should have been made. In large part, these factual contentions appear to be designed to establish that the maximum prices set by Yum and Yum's methodology in setting those prices were objectively unreasonable. Given that we have rejected the appellant's legal contentions in relation to implied terms and construction of the International Franchise Agreement, it may be strictly unnecessary to consider the factual contentions set out in grounds 1-10 and 13 of the notice of appeal. Nevertheless, at least for the sake of completeness, we address each of those grounds (save for the grounds or parts of grounds that are not pressed), on the basis that the appellant is correct that a standard of objective reasonableness, in the sense contended for by the appellant, should be applied: see [157]-[158] above. This, as we have explained, is distinct from an objective element of reasonableness in fair dealing, within a duty of good faith and reasonableness: see [184] and [186] above.

223 It is important to reiterate, at the outset of this section of our reasons, that the appellant does not challenge the primary judge's findings as to the subjective state of mind of any officer of Yum. As noted above, this was reflected in paragraph 3 of the 10 March 2017 orders and the appellant's written and oral submissions on the appeal. Thus, to the extent that parts of grounds 1-10 and 13 appear to involve a challenge to the primary judge's findings as to the subjective state of mind of any officer of Yum, we will treat these parts of the grounds as not intending to make such a challenge.

224 We do not deal separately with ground 1, as it is principally concerned with the scope and content of the implied duty of good faith and reasonableness, which we have already addressed. To the extent it raises factual contentions, these matters are addressed

in our reasons in relation to the other grounds as set out below. Likewise, we do not deal separately with ground 2, as it is premised upon the implied term found by the primary judge (at Reasons, [359]) that we have rejected and, to the extent that it raises factual contentions, it does so by reference to grounds 3 to 10 of the notice of appeal, which we deal with below (to the extent pressed).

Grounds 3 and 4

225 Grounds 3 and 4 of the notice of appeal (set out at [146] above) both concern the Yum Model. It is therefore convenient to deal with these grounds together. In part, at least, sub-paragraph (a) of ground 3 appears to challenge the primary judge's findings as to the subjective state of mind of Yum officers. Consistently with what we have said above, we will treat these sub-paragraphs as not intending to make such a challenge. The focus of ground 3 concerns the inclusion in the Yum Model of 13 hours per week, as the assumed number of hours of additional labour needed to support a 34.5% uplift in transactions (that is, an uplift of 218 transactions per store per week, from 635 to 853).

226 Argument in relation to these grounds focused on the iteration of the Yum Model that we have set out at [85]-[87] above.

227 The appellant notes that the primary judge concluded (at [410]) that subsequent analysis showed that Mr Houston's faith in the Yum Model "may have been misplaced", and that her Honour had earlier found:

(a) at [368], that it may be that Mr Houston was naïve or did not himself delve into the Yum Model or the ACT Test results to conduct or consider an appropriate analysis, and that Mr Houston may have demonstrated poor business judgment with the benefit of hindsight; and

(b) at [371], that the Yum Model, particularly in relation to the labour hours used and its reliance on the New Zealand data, was "validly subject to comment and some criticism".

228 The appellant submits that the following three preliminary matters may be observed:

(a) First, the officers of Yum responsible for the Yum Model, Mr Purcell and Glenda Vasco, were not called at trial, and *Jones v Dunkel* (1959) 101 CLR 298 applies to any inferences that may be drawn about the model.

(b) Secondly, the Yum Model was incomplete as at 4 June 2014, when Mr Houston made his decision. A copy of the model on which Mr Houston made his decision was not produced by Yum. Six iterations of the model were in evidence. The model was not finalised until 19 June 2014, and was exhibited to an affidavit of Mr Smith dated 23 June 2014.

(c) Thirdly, there is no basis for a finding that the Yum Model was shown to Franchisees prior to Mr Houston making his decision (cf Reasons, [365], [424]). The decision of Mr Houston preceded any announcement to the Franchisees of the Value Strategy. Yum's evidence was that the Yum Model (in some form) was only shown to certain Franchisees after the announcement on 10 June 2014.

229 It is convenient to note at this point that Yum accepts that the Yum Model was not shown to Franchisees before the decision was made, on 4 June 2014, to adopt the Value Strategy, and that her Honour erred in finding that it had been shown to Franchisees before this date, but submits that the error is not material.

230 In relation to labour costs, the appellant's submissions can be summarised as follows:

(a) A primary aspect of the incomplete Yum Model was the treatment of additional labour costs. A 34.5% increase in transactions required the average Franchisee to process an additional 218 transactions per week, which involved making an additional 703 pizzas per week. (In oral submissions, counsel for the appellant said (T102) that the figure of about 700 additional pizzas was common ground. This was not disputed and reflects Mr Houston's evidence: trial transcript, p 746.) In the final version of the Yum

Model, Yum included 13 additional labour hours to achieve this increase. In the 3 June 2014 draft of the Yum Model, only 2.1 additional labour hours were included, but this was increased to nine additional hours in the 6 June 2014 version.

(b) Mr Sinha, the relevant Yum executive who provided the labour inputs for the Yum Model, relied on two data points and his own experience. Mr Sinha incorrectly analysed the first of these data points, being certain New Zealand labour data, as the primary judge found at [380]. In summary, he used forecast data rather than actual data from New Zealand.

(c) The second objective data point was the ACT Test data. As the primary judge noted at [386], DPL's expert, Mr Potter, demonstrated that, on his analysis of the ACT Test data, significantly more than 13 additional labour hours were required. His calculation was that the correct number was 52 additional hours, which would produce a material loss for Franchisees under the Yum Model, even at a 34.5% transaction uplift.

(d) The difference between the conclusions drawn by Mr Potter and Mr Sinha about the ACT Test data concerned the implication of the 7,104 "extra deliveries" that occurred during the ACT Test. Mr Sinha explained that the ACT Franchisee guaranteed work for delivery drivers in anticipation of extra delivery volumes that did not occur. The "extra deliveries" were paid for on a 'per delivery' basis (called Method B) and not on an hourly rate basis (called Method A). These two methods were accounted for separately in the ACT labour cost summary and timesheets. This led to a subsequent email exchange between Mr Sinha and the ACT Franchisee about the costs of the extra deliveries, in which the ACT Franchisee advised that delivery drivers were being used as substitute kitchen-hand labour, even though Mr Sinha had not seen any evidence of this occurring. As delivery drivers were paid at a different rate to crew members, these two labour costs were recorded separately by the ACT Franchisee. The objective inference to be drawn from this evidence is that kitchen hand (crew member) labour hours were understated as an element of total labour costs in the ACT Test.

(e) The primary judge made no findings about how the "extra deliveries" cost should have been treated. Mr Sinha calculated the additional labour costs for the Yum

Model using the kitchen hand hours for all eight outlets in the ACT without any adjustment for the "extra delivery" costs. On the other hand, Mr Potter made an adjustment by using the kitchen hand hours for the Erindale outlet only, as it was the least affected by the "extra delivery" issue (see Reasons, [94]). As this issue involved an objective consideration of the test data, Mr Potter was as well placed as Mr Sinha to interpret that data. The relevant question is not that asked by the primary judge at [383] as to whether it was reasonable to use Mr Sinha rather than an accountant to interpret the data, but whether it was reasonable to make an adjustment for the "extra delivery" labour costs in the ACT Test.

(f) The approach adopted by Yum in calculating the number of additional labour hours was objectively unreasonable, and the primary judge erred in not so finding.

231 For the following reasons, in our view, the appellant has not established that Mr Sinha failed to take reasonable care in including in the Yum Model the figure of 13 hours per week, as the assumed number of hours of additional labour needed to support a 34.5% uplift in transactions. First, Mr Sinha's evidence at trial was to the effect that he based the figure on his own experience, the ACT Test results and labour figures from New Zealand following the introduction of a value strategy there by RBNZ (see Mr Sinha's affidavit dated 16 July 2015 at [25]-[39]) and that he undertook a detailed analysis of what the likely increase in labour needs would be (at [65]-[85] of the same affidavit). The effect of Mr Sinha's evidence was summarised in Yum's submissions at trial, which are set out at [90]-[91] above. The primary judge did not make any adverse credibility findings in relation to Mr Sinha and appears to have accepted his evidence as a reliable account of the process he undertook in arriving at the figure of 13 additional hours for variable labour. Accordingly, we proceed on the basis that Mr Sinha's account of the process he undertook is to be accepted.

232 Secondly, in relation to the New Zealand data, the appellant's contention that Mr Sinha relied on forecast data rather than actual data would appear to be correct. In his affidavit dated 16 July 2015, Mr Sinha referred at [28] to information he had received in

an email from David Hill (the Franchise Relationship Manager of RBNZ) containing information about the New Zealand experience with labour. In this email (AB Pt C, tab 65), the figure of 5.6 MPD, which Mr Sinha used as the New Zealand benchmark, appears on the third page in connection with forecast data. But, as the primary judge found at [380] of the Reasons, even accepting that Mr Sinha used an incorrect data point from New Zealand, this was only one of the matters relied upon by Mr Sinha, and New Zealand was merely used as a comparator.

233 In the course of oral submissions, counsel for the appellant handed up an 'aide memoire' document, setting out certain minutes per docket calculations. On the top half of this page, the basis upon which Mr Sinha calculated the figure of 5.84 MPD (in relation to 853 dockets or transactions per week) was set out. (The figure of 5.84 MPD is referred to in the summary of Mr Sinha's evidence set out at [91] above.) In the second part of the aide memoire, the appellant set out calculations of the additional labour cost (per week for the national average store) based on actual (rather than forecast) New Zealand data. The actual New Zealand data was either 6.68 MPD or 6.9 MPD. The appellant also referenced the evidence in [73] of Mr Sinha's affidavit and the cross-examination of Mr Sinha at trial transcript, p 912. The evidence given during cross-examination makes clear that Mr Sinha did use forecast rather than actual data from New Zealand. However, the evidence in cross-examination does not go so far as to establish that it was inappropriate or unreasonable for Mr Sinha to rely on the New Zealand forecast data as a comparator in the way in which he did. Nor does it establish that, when regard is had to the other matters taken into account by Mr Sinha, the figure of 5.84 MPD (in relation to 853 dockets or transactions per week) was inappropriate or unreasonable.

234 Thirdly, in relation to the implication for labour costs of the "extra deliveries" costs incurred during the ACT Test, it may be accepted that some of the people engaged for "extra deliveries" were in fact utilised as additional kitchen hands and that Mr Sinha did not take this into account in his additional labour hours calculation (see trial transcript, pp 941-944 and the email exchange between Mr Sinha and Harpreet Singh

from the ACT Franchisee at AB Pt C, tab 68). But this passage of Mr Sinha's evidence during cross-examination also includes (at trial transcript, p 943) his explanation that: Mr Singh "did not tell me that they're all helping and it's happening every time"; it was difficult for him (Mr Sinha) to segregate the data; "moving forward, I asked [Mr Singh] to make sure that it is not happening"; and Mr Singh had confirmed on "repeated occasions" that it was "taken care of". In light of her Honour's general approach to Mr Sinha's evidence, this evidence is to be accepted. The cross-examination and other evidence upon which the appellant relies does not establish the extent to which the utilisation of people engaged for "extra deliveries" as kitchen hands during the ACT Test affected the figures. Nor does it establish a failure to take reasonable care on the part of Mr Sinha. It is also important to note that Mr Sinha relied on his own experience and not only on the ACT Test data in arriving at the appropriate labour hours figure (see Reasons, [379]).

235 Fourthly, and more generally, the primary judge concluded, in effect, that reasonable minds may differ as to the approaches taken by Mr Sinha and Mr Potter, the expert called by the appellant (Reasons, [383]-[385]). The matters relied upon by the appellant do not establish that it was not open to her Honour to reach this conclusion.

236 In relation to the fact that Yum did not call Mr Purcell (who, as noted at [92] above, had primary responsibility for the structure of the Yum Model and for entering data into the model) or Ms Vasco (who, the documents in the Appeal Book indicate, was also involved in the preparation of the Yum Model), we do not consider that an adverse inference should have been drawn in relation to the labour hours issue, in circumstances where Mr Sinha (who had the carriage of the labour hour inputs into the Yum Model) was called to give evidence. In the circumstances, and in relation to this issue, the evidence would have been merely cumulative.

237 In relation to the various iterations of the Yum Model, and the question when the figure of 13 additional labour hours was included, on the face of the documents there

would appear to be some force in the appellant's contention that it was included at a point in time *after* the decision to launch the Value Strategy was made on 4 June 2014: see DPL's summary of the various iterations of the Yum Model at AB Pt C, tab 9. However, as noted in [84] above, Yum submitted at trial that the Yum Model was discussed on 3 and 4 June 2014, where it was displayed on a screen, and Mr Sinha gave evidence that the 13 additional labour hours were included in the Yum Model during the course of those meetings. Although her Honour did not make a finding on the point, in view of her Honour's general approach to Mr Sinha's evidence, we consider that Mr Sinha's evidence in this regard should be accepted.

238 As for her Honour's finding to the effect that the Yum Model was shown to Franchisees before the decision was made, on 4 June 2014, to adopt the Value Strategy (Reasons, [365], [424]), as noted above, Yum accepts that this was in error. But the error was not material to her Honour's decision. It was not Yum's case below that the Yum Model had been shown to Franchisees before the decision was made. It appears from [120] of the Reasons that her Honour understood the correct chronology. In any event, her Honour relied on a number of matters in reaching her conclusions concerning the decision to adopt the Value Strategy, and we do not consider these references to have had a significant bearing on those conclusions.

239 In light of these matters, we would dismiss grounds 3 and 4.

Ground 5

240 Ground 5 of the notice of appeal concerns the ACT Test. The appellant contends, in summary, that the primary judge erred in finding (by implication) that Mr Houston and Yum were justified in relying on the ACT Test results and that Ms Broad's analysis of those results was not unreasonable, and that the primary judge ought to have found that: there was no reasonable or proper basis for Yum or Mr Houston to have concluded that the ACT Test was a success; the ACT Test was a failure on any reasonable or proper analysis; and the analysis by Ms Broad that the ACT Test led to an improvement in

Franchisee profitability was not a reasonable or proper analysis of the ACT Test data.

241 The appellant submits that: objectively, the ACT Test demonstrated that Franchisees would incur significant losses under a value strategy and the primary judge ought to have so found; the financial statements produced by the ACT Franchisee demonstrated that it had lost $141,000 over the 12 weeks of the ACT Test; and Yum treated that information as being reliable, as it paid the ACT Franchisee the amount of that loss, together with $51,000 for maintaining the lower prices after the test concluded (Reasons, [49]). (The appellant refers in its submissions to $141,000 but the primary judge referred to $143,000. The latter figure represents the amount paid by Yum to the ACT Franchisee: see Mr Houston's affidavit dated 27 November 2014 at [100]).

242 For the following reasons, in our view, the appellant has not established error in the primary judge's findings regarding the ACT Test results or that her Honour ought to have made findings as contended for by the appellant.

243 First, for the reasons set out in Mr Houston's evidence (which her Honour generally accepted), he regarded the ACT Test as a success. In particular, he regarded it as a success on the basis of the sales growth, transaction growth and profit growth: see Mr Houston's affidavit dated 27 November 2014 at [96].

244 Secondly, Mr Houston provided a description of the ACT Test results during different stages of the test: see [95] of the same affidavit. He stated that, in the first four weeks of the test, the results were poor, for reasons he explained. However, he stated that weekly store level profits increased significantly over the notional level of profit or loss for the same period in the previous year during weeks 5 to 10 of the test. In relation to weeks 11 and 12, he stated that the test coincided with the Easter and Anzac Day weekend holidays and that these weeks were also a school holiday period in the ACT and a period when Parliament did not sit. Accordingly, Mr Houston regarded the results over weeks 11 and 12 as an anomaly and disregarded them. (We note for completeness that, in

the appellant's outline of submissions, it states in a footnote that Yum's internal analysis of the ACT Test excluded the data after week 10 on the basis of an incorrect understanding of the timing of school and public holidays, referring to exhibit AT. We were not taken to this document (AB Pt C, tab 32) during oral submissions. On the face of it, it seems to confirm that school holidays did take place during weeks 11 and 12 of the ACT Test.)

245 Thirdly, Mr Houston explained, at [100] of that affidavit, the arrangements between Yum and the ACT Franchisee regarding payment for loss. He stated that: he agreed that Yum would underwrite the ACT Franchisee's profits during the test to ensure that it did not suffer any loss; after the test had finished on 28 April 2014, the ACT Franchisee maintained the same price points but without the advertising support that Yum had provided during the test period; even though in weeks 5 to 10 of the test, the ACT Franchisee's business was EBITDA positive in the stores, after bringing to account various overheads and other obligations, the ACT Franchisee nevertheless suffered a loss over the period of the test; the loss was less than it had suffered in the previous 12 weeks; as he had agreed on Yum's behalf to underwrite any losses during the test period, Yum paid the ACT Franchisee $143,000 to make good those losses; and Yum also paid the ACT Franchisee $51,000 to make good its losses in the period after completion of the test. That the ACT stores were EBITDA positive during weeks 5 to 9 is demonstrated by the spreadsheet at AB Pt C, tab 29. Mr Houston gave further evidence regarding the arrangement to underwrite losses at trial transcript, pp 525-526.

246 Fourthly, it is important to note that DPL's case at trial in relation to Ms Broad's analysis of the ACT Test results, and the presentation of those results to Franchisees, was much broader than the case now made by the appellant. As recorded in [374] of the Reasons, DPL alleged that Ms Broad deliberately engineered the results to obtain a false picture of profitability. Her Honour concluded that DPL had not established this.

247 Fifthly, her Honour found that Ms Broad's decisions, such as which weekly

periods to include, had "not been shown to be unreasonable or to invalidate her conclusions" (at [374]). Further, after noting that a key issue was whether the 4% Additional LSM should have been included, her Honour said she was "not satisfied that it was inappropriate to exclude it at the time that the calculations were made" (at [375]). These findings and conclusions were open to her Honour on the evidence, including Ms Broad's affidavit evidence.

248 For these reasons, we would dismiss ground 5.

Ground 6

249 This ground relates to the reliance placed by Yum or Mr Houston on the New Zealand results. The appellant relies, in particular, on the email exchange between Mr Houston and Mr Creedy on 20 and 22 May 2014 set out at [76] and [77] above. As set out in Mr Creedy's email and as noted at [78] above, there were significant differences between the Australian and New Zealand markets. The appellant contends that, given the differences, the primary judge ought to have found that the New Zealand pricing strategy was not comparable to the Value Strategy, and there was no reasonable or proper basis for any conclusions to be drawn by Yum or Mr Houston to the effect that the introduction of the Value Strategy could be supported by reference to the New Zealand experience.

250 In our view, the appellant has not established error by the primary judge in relation to Mr Houston's decision-making insofar as he relied on results from New Zealand. The results from New Zealand were merely one factor taken into account by Mr Houston in deciding to adopt the Value Strategy, as indicated in the Reasons at [363]. It has not been shown that, to the extent he relied on those results, it was unreasonable to have done so.

Ground 7

251 Ground 7, which relates to Domino's and any first mover advantage, is set out at

[146] above.

252 The appellant's written submissions include submissions to the following effect, which appear to relate to this ground of appeal:

(a) It is not clear why Mr Houston made his decision to adopt the Value Strategy on 4 June 2014, before the Yum Model was complete. The point of the Value Strategy was to bring about a 34.5% uplift in transactions. Yum's decision was based on a belief that it would obtain a first mover advantage over Domino's. This was found, at [370] of the Reasons, to be an "assumed factor" in the Yum Model.

(b) The primary judge found, at [399], that Yum appreciated or should have appreciated, by 13 June 2014, that any first mover advantage would be short-lived or diminished. The primary judge also found, at [415], that information that Domino's had responded in the ACT with television advertising was or should have been known by Yum in the five weeks preceding 13 June 2014. In this respect, the primary judge was critical of Ms Syed for not passing on that information to the Yum leadership team. (The evidence shows that Domino's started television advertising on 2 April 2014, that Ms Syed was so advised on 3 June 2014, and that she passed on this information to the Yum leadership team on 13 June 2014.)

(c) Without a 34.5% transactions uplift, the Value Strategy would result in losses to Franchisees on any of the versions of the Yum Model in evidence. The sales and transactions data in the ACT showed that once Domino's responded to the lower Pizza Hut prices, which it did from week 9 of the ACT Test onwards, the ACT Franchisee experienced a downward trend in sales and transactions from which it never recovered.

(d) Ms Syed conceded that once Domino's had the ability to respond to the Value Strategy by a television commercial, any first mover advantage would be limited to a matter of days. Although it was not clear that Mr Houston appreciated the facts about Domino's response in the ACT (Reasons, [415]), he knew that it would respond and that the price of $4.95 could not be sustained for more than a few weeks – views which he

reported to his US superior, Mr Bergren, on 3 June 2014 (Reasons, [160]).

(e) The combination of the objective evidence in relation to the losses in the ACT, and the inapplicability of the assumption in relation to Domino's and the "first mover" advantage, is sufficient to render the decision to proceed with the Value Strategy unreasonable, and lacking in any reasonable basis. The position was exacerbated by Yum's failure to complete the Yum Model, and the absence of any sensitivity analysis in the model concerning Domino's possible responses.

253 In oral submissions, counsel for the appellant submitted (T80) that if, as contended by the appellant, "the test is an objective test that Yum must act reasonably", then seven propositions were relied upon to show that, in exercising the contractual power to set maximum prices (on 10 June 2014), Yum did not so act. Although we have rejected the appellant's legal contentions as to the applicable duty, we will nevertheless consider these factual submissions for the sake of completeness. The seven propositions were as follows:

(a) The prices (prescribed as part of the Value Strategy) were only reasonably capable of allowing Franchisees to break even if there was a 34.5% uplift in transactions and Yum's assumption as to 13 additional labour hours was valid.

(b) The 34.5% transaction uplift was only reasonably likely to occur if Domino's did not react on television for at least four to six weeks, so that Pizza Hut could establish its value message in the mind of consumers.

(c) Mr Houston, at least, assumed that Domino's would not react on television and did not have a television commercial available in June 2014 for an immediate launch of a $4.95 every day strategy.

(d) If, as was the fact, Domino's did have a television commercial then, on Ms Syed's evidence, Domino's could react within one to two days and the 34.5% uplift could not be achieved.

(e) Yum positively knew, as at 6 June 2014, of Domino's television

commercial (see Ms Syed's evidence). Further, from 5 April 2014 onwards, Yum had information that, with the benefit of reasonable inquiries, would have established the existence and content of Domino's television commercial.

(f) Therefore, the Value Strategy and the reduced prices that formed part of it, as at 10 June 2014, were certain to fail in terms of increasing Franchisee profitability, even accepting that everything Yum believed about the first mover advantage was objectively reasonable.

(g) Having regard to Mr Houston's lack of knowledge of Domino's reaction on television, the fact that his motives were honest or his views honestly held is irrelevant to the question whether Yum's decision to exercise its contractual power to set maximum prices on 10 June 2014 was reasonable.

254 In the course of oral submissions, counsel for the appellant relied on Ms Syed's affidavit dated 28 November 2014 at [56]-[58] for the proposition that it takes some time to develop a television commercial.

255 The appellant also relies on the evidence of Ms Syed at trial transcript pp 1271-1272 for the proposition that there was never any reasonable prospect of Pizza Hut obtaining the benefit of any sustainable first mover advantage. In this passage of the cross-examination, Ms Syed was asked questions about her email to the Yum leadership team dated 13 June 2014 (set out at [106] above). Ms Syed expressed the view that the first mover advantage "had a role to play". She also said that she believed Domino's would respond, "which is why the first mover advantage was really, really important". It was put to her that Domino's already had a television advertisement "ready to go". She responded: "Possibly. Yes." We take this to be an acceptance of the proposition, given the terms of her email dated 13 June 2014. It was then put to her that Domino's would have booked advertisements for their national advertising campaign (ie, apart from any response to the Value Strategy) at that point in time. Ms Syed accepted that proposition too. It was then put to her that, consistently with earlier evidence she had given about the capacity of businesses to substitute one advertisement for another, it would have been

open to Domino's to immediately substitute the television commercial they had prepared. Ms Syed accepted that this would be the case "[i]f they knew when we were launching". It was put to her that Domino's could have done this (ie, substituted its television commercial for a $4.95 every day price point for its pre-existing advertising campaign) "from day two" of Yum's Value Strategy, to which Ms Syed responded: "Possibly."

256 There is some force in the appellant's criticisms of Yum's processes leading up to the decision, on 4 June 2014, to adopt the Value Strategy, and the communication of that strategy to Franchisees on 10 June 2014. In particular, in circumstances where the purpose of the ACT Test was to trial the proposed Value Strategy and an important factor in evaluating the merits of the strategy was the likely response of Yum's main competitor, Domino's, it is deserving of criticism that Yum seems not to have done very much to follow up the information it received, on 5 April 2014, that Domino's had a television advertisement for a $4.95 price point in the ACT (see [52] above), and that Ms Syed did not inform Mr Houston, in early June 2014, of information she had by that stage received that Domino's had indeed responded with television advertising in the ACT (see [101]-[103] above). In his affidavit dated 27 November 2014, Mr Houston stated at [121] that, by 4 June 2014, he had formed the view that while Domino's was very likely to react in some way to a national launch of a value strategy by Pizza Hut, "that reaction was not likely to be aggressive or supported by a national advertising campaign involving television advertising". However, the information upon which he based this view was inaccurate or incomplete. It is not clear to us that the criticism should be sheeted home only to those below Mr Houston. We note, for example, that he was copied in on the 5 April 2014 email from Mr Sinha set out at [52] above.

257 However, for the reasons that follow, in our view, the appellant has not established on the basis of the matters referred to above that, in exercising the contractual power to set maximum prices, Yum failed to act reasonably in an objective sense.

258 First, the decision to adopt the Value Strategy was a commercial decision based

on a range of factors. The likely response of Domino's was an important factor to be taken into account, but it was only one factor in deciding whether to adopt the Value Strategy and exercise the contractual power to set maximum prices.

259 Secondly, although (understandably enough) the appellant focuses on the maximum prices set by Yum, it needs to be remembered that these were but one part of a detailed strategy comprising a package of measures (including menu changes, a media and leaflet plan, and changes to the menu panel layout and the point-of-sale layout) as set out in the document at AB Pt C, tab 11.

260 Thirdly, it did not necessarily follow from the fact that Domino's had developed a television commercial for a $4.95 every day price point, that it would respond immediately (or almost immediately) to the Value Strategy. In the ACT, Domino's had not responded until week 9 of the test. In order to respond nationally, Domino's would need to communicate with its franchisees and take other steps to prepare its stores.

261 Fourthly, once Mr Houston became aware, on 13 June 2014, of the fact that Domino's had responded with television advertising in the ACT, he did not at that point reconsider the decision to adopt the Value Strategy. This suggests that, while this was a relevant matter that ought to have been taken into account in Yum's decision, it was not of such a magnitude that it would necessarily have altered the decision. We note that counsel for the appellant did not submit that it was not possible for Yum to reverse its decision regarding the Value Strategy in the period immediately following 13 June 2014 (see T83-84).

262 Fifthly, in considering the reasonableness of Yum's decision to adopt the maximum price of $4.95 for the Classics range of pizzas, it is relevant to note that Domino's had already been offering that price two days a week (albeit only on take-away pizzas).

263 Sixthly, regard must be had to the entrepreneurial nature of the decisions capable of being made by Yum as the franchisor under the International Franchise Agreement. The franchise structure established by that agreement gave Yum broad discretionary powers. Ultimately, Yum pays a commercial price if it makes poor business decisions, as returns from Franchisees will fall and fewer people will want to be franchisees. While these considerations tend to reinforce the view we have reached as regards the appellant's legal contentions, they are also relevant in considering whether a particular decision (here, to adopt the Value Strategy) was objectively unreasonable.

264 Having regard to these matters, it is not shown that Yum failed to act reasonably in exercising the contractual power to set maximum prices.

265 We do not consider it necessary to reach a view on whether, for the purposes of determining the reasonableness or otherwise of Yum's exercise of the contractual power to set maximum prices, it is permissible to aggregate the knowledge of various Yum officers. The appellant's contentions rely on some form of aggregation. Even if it is permissible to aggregate the knowledge of various Yum officers, the appellant has not established that Yum failed to act reasonably, for the reasons set out above.

266 Paragraphs 7(a)(ii), (b)(iii) and (b)(iv) of the notice of appeal relate to Domino's decision to offer a $4.95 price point every day (on take-away pizzas) and the primary judge's finding (at [419]) that once this occurred Yum "really had no choice but to follow with the already planned VS". It may be accepted that, but for Yum's decision to adopt the Value Strategy, which appears to have been leaked to Domino's, Domino's probably would not have decided to offer a $4.95 price point every day on take-away pizzas. The Stubbs email supports such an inference. But Domino's response merely forms part of the chronology of events after Yum had exercised its contractual power to set maximum prices. It is therefore difficult to see how this aspect of these grounds of appeal substantially advances the appellant's case on breach of contract, which is primarily directed to the exercise of the contractual power to set maximum prices. Insofar as the

primary judge found that, once Domino's announced that it would be offering a $4.95 price point every day, Yum really had no choice but to proceed with the Value Strategy, this finding is supported by the evidence and was open to her Honour to make. It is true that Domino's $4.95 offering was limited to take-away pizzas, while Yum's Value Strategy applied the $4.95 price point to both take-away and delivered pizzas (with an extra fee applying to delivered pizzas), but the appellant has not established that this particular difference undermines her Honour's finding. The Value Strategy (with the $4.95 price point for both take-away and delivered pizzas) had already been decided upon and communicated to Franchisees.

267 In ground 7(b)(v) of the notice of appeal, the appellant contends that the primary judge ought to have found that the Value Strategy was not a reasonable or proper response by Yum as franchisor to the decline in market share of Pizza Hut compared to Domino's. In the course of oral submissions, counsel for the appellant challenged the proposition that Pizza Hut was a business in crisis, noting that Yum had experienced a growth in profits (see AB Pt C, tab 13). But other documents, such as the business trajectory slide set out at [57] above, show declining sales, and it is common ground on the appeal that Pizza Hut had been losing market share (see [46] above). There was also material that supported the proposition that Pizza Hut had a "value problem", in that consumers in Australia had rated it lower than Domino's in terms of value for money (see, eg, AB Pt C, tab 34). The appellant has not established that the primary judge ought to have made the finding contended for by the appellant.

268 In light of the above, we would dismiss ground 7.

Ground 8

269 Ground 8 is not pressed.

Ground 9

270 Ground 9, which is set out above (insofar as it is pressed), relates to the expected

financial impact of the Value Strategy. In particular, the appellant contends that the primary judge erred in finding that:

(a) the decision to implement the Value Strategy involved careful consideration by Mr Houston of the appropriate maximum price, and that he made what he considered to be the best decision from the point of view of Yum and the future profitability of the Franchisees (at Reasons, [363], [387]);

(b) Yum believed that the Value Strategy would help reverse declining profits and result in increased profits for Franchisees, and was an opportunity for Franchisees to achieve a short term or longer term benefit (at [359]);

(c) the relevant question to be considered in relation to the cost of production of a pizza was limited to the cost of ingredients only, and that the experts had so agreed (cf [311], [367]); and

(d) the $4.95 "Classics" pizza could be viewed as a loss leader to bring about a substantial increase in overall sales and increased profitability for both Yum and the Franchisees (at [388]).

271 In part, these contentions appear to challenge findings made by the primary judge concerning the subjective state of mind of officers of Yum. As indicated above, we will proceed on the basis that they are not intended to do so.

272 Insofar as her Honour found (at [363] and [387]) that the decision to implement the Value Strategy involved careful consideration by Mr Houston of the appropriate maximum price, the finding was supported by the evidence before the primary judge and was open to her Honour.

273 The finding at [359] is concerned with the subjective state of mind of Yum officers, and therefore we do not deal with this aspect of ground 9.

274 Insofar as the appellant challenges a finding said to have been made at [311] and

[367] to the effect that the relevant question to be considered in relation to the cost of production of a pizza was limited to the cost of ingredients only, it is not clear that her Honour made such a finding. On our reading of [311], her Honour was merely recording submissions made by DPL. And in [367], her Honour accepted that "other costs must be taken into account in allowing for store profitability such as overheads". However, her Honour considered that DPL had not established that it was incumbent upon Yum to take account of depreciation and cost of capital. It was open to her Honour to make these findings and reach these conclusions.

275 Insofar as her Honour stated, in the last sentence of [388], that the $4.95 Classics pizza "could be viewed as a 'loss leader' to bring about a substantial increase in overall sales", this does not appear to reflect Yum's conception of the Value Strategy. But we do not read that sentence as material to her Honour's decision. It is merely expressing a possible way of viewing the matter.

276 Paragraph 9(b) of the notice of appeal contains certain findings it is contended that the primary judge should have made. It is contended that the primary judge ought to have found that Yum did not undertake any modelling or sensitivity analysis of its pricing strategies, beyond the incomplete modelling of the Value Strategy based on a price below $5 for Classics pizzas. While it appears to be the case that Yum did not carry out a sensitivity analysis of its pricing strategies, the appellant has not demonstrated that it was necessary for Yum to do so in order for it to exercise the contractual power to set maximum prices reasonably in an objective sense. Accordingly, this contention does not go anywhere. In relation to paragraphs 9(b)(ii) and (v), we refer to our reasons, above, in relation to her Honour's findings about these matters.

277 In light of the above, we would dismiss ground 9.

Ground 10

278 Ground 10 concerns the date of Yum's decision to adopt the Value Strategy. In the

notice of appeal as filed, this ground includes a contention that the primary judge ought to have found that Yum "made the decision to implement the VS on about 16 April 2014". That contention reflects the position adopted by DPL at trial (see Reasons, [402]). However, the appellant no longer presses that aspect of ground 10. On the hearing of the appeal, the appellant proceeded on the basis that the decision was made on 4 June 2014. This is consistent with Yum's position at trial (see Reasons, [402]). Accordingly, it is common ground that the decision was made on 4 June 2014. In these circumstances, the balance of ground 10, although still pressed, does not seem to go anywhere. We would dismiss ground 10.

Ground 13

279 Ground 13 relates to the state of mind of the officers of Yum who participated in the decision-making process that led to the implementation of the Value Strategy. It is contended that the primary judge erred in directing herself to the question whether the Yum witnesses had acted to the best of their ability, and believed in the accuracy and honesty of the reasons for their conduct and the decisions made by them (at Reasons, [429]-[431], [433]). This contention is essentially concerned with the state of mind of the officers of Yum, which the appellant does not challenge.

280 The appellant also contends that the primary judge ought to have found, in respect of each of Mr Houston, Ms Broad and Mr Sinha, that none of them gave reasonable and proper consideration to the evidence available to Yum in their respective areas of responsibility as set out in grounds 1 to 12 above. It appears that the appellant relies on the same factual contentions as for the grounds discussed above. We refer to our consideration of those other grounds.

281 For these reasons, we would dismiss ground 13.

Additional matters

282 We have approached our consideration of grounds 1-10 and 13 of the notice of

appeal generally on the basis of the appellant's legal contention (which we have rejected) that Yum was under a duty to act reasonably in an objective sense in exercising the contractual power to set maximum prices. If and to the extent that the appellant relies on the same factual contentions in support a contention (see ground 1(b)(iii) of the notice of appeal) that the primary judge ought to have found that no reasonable person making a rational and proper business judgment would have made the decision, we would reject that contention for the same reasons.

WHETHER YUM IS LIABLE TO THE FRANCHISEES IN NEGLIGENCE

283 Ground 11 of the notice of appeal, which relates to the appellant's alternative claim in negligence, is set out at [146] above.

284 The appellant's submissions in support of this ground can be summarised as follows:

(a) The principal issue canvassed below, and not the subject of any express finding by the primary judge, was whether Yum owed a duty of care to the Franchisees. That duty arises in the present case because of the multilateral nature of the Pizza Hut business or "System", as referred to at [361] of the Reasons. Apart from the "Background Facts", set out in the recitals to the agreement, there is nothing in any of the International Franchise Agreements that recognises the multilateral nature of the arrangement.

(b) Thus, the ordinary relationship between contract and tort in commercial contracts does not preclude the existence of a duty of care in the present case, as the other indicia of a duty of care are present – proximity, assumption of responsibility, vulnerability of the Franchisees to the way in which the business as a whole is conducted, reliance by the Franchisees on the judgment of the franchisor in making system-wide decisions, and the foreseeability of harm: see *Sullivan v Moody* (2001) 207 CLR 562 at [50]; *Caltex Refineries (Qld) Pty Ltd v Stavar* (2009) 75 NSWLR 649 at [100]-[106]; *Brookfield Multiplex Ltd v Owners Corporation Strata Plan 61288* (2014) 254 CLR 185

at [24], [33], [58], [133].

(c) Absent a duty of care, the franchisor would be entitled to make decisions for the system or business as a whole that are contrary to the individual Franchisee's interests, and outside the terms of an individual franchise contract – for example, if the findings in relation to subjective honesty were to be upheld as determinative of the contractual claims.

(d) The primary judge found that it had not been shown that Yum had acted negligently at [385], [424]. These findings proceed on a mischaracterisation of DPL's claim. The duty pleaded at paragraph 11 of the statement of claim was to make decisions to *allow* Franchisees ("can") to make, maintain or increase their profitability, to avoid causing losses, and to not set unprofitable prices for pizzas, not a duty to *ensure* profitability.

(e) A key feature of the negligence case was Mr Potter's evidence that the $4.95 price was an unprofitable price for "Classics" pizzas. He reached this conclusion by reworking the Yum Model to deduce the costs of the transactions (being Yum's unit of measure) for each of "Classics" and "Favourites" pizzas. Contrary to the primary judge's finding at [385], the only difference in the models was the nature of the outputs, as Mr Potter used Yum's data to identify explicitly the cost that was implicit in its model. Yum never undertook a profitability analysis, nor did it advance any positive case to demonstrate that the $4.95 price for "Classics" was profitable. This was not a case of reasonable minds differing (cf Reasons, [386]).

(f) Mr Potter produced several iterations of his reworked Yum Model. In the first, he used Yum's 13 additional labour hour assumption to show that the $4.95 price was loss-making, even after allowing for compensating price differences from sides and drinks contained in the model. This loss was exacerbated when Mr Potter used the higher labour figure of 52 hours that he derived from the ACT Test.

(g) Thus understood, the primary judge's findings of a lack of negligence by Yum cannot be sustained.

(h) The appellant otherwise relies on its submissions in relation to the contract grounds on the question of breach of duty.

285 In our view, the appellant has not established that Yum owed a duty of care, as alleged, to each of the Franchisees. The duty of care alleged by DPL in the statement of claim was similar in many respects to the implied terms relied on as part of the contract case. After alleging, in paragraph [10] of the statement of claim, that Yum provides services as the franchisor of the Pizza Hut System to each of the Franchisees, including by exercising the powers given to Yum in the International Franchise Agreements (defined as "Yum Services"), it was alleged that:

> 11. By reason of paragraphs 5-10, Yum owes a duty of care to the Applicant and to each of the Franchisees in relation to any conduct or decision by Yum in performing the Yum Services, and/or in the exercise its powers, as franchisor of the Pizza Hut System under the respective IFAs so that:
>
> a. the Applicant and each other Franchisee can operate its and their respective Pizza Hut Outlets to Make, Maintain and/or Increase Profits from operating its or their respective Outlets (as those terms are defined in paragraphs 9 and 9A); and/or
>
> b. the Applicant and each other Franchisee does not experience a lower level of Profits (as that term is defined in paragraph 9A(a)) or a loss from operating its or their respective Outlets as a consequence of that conduct or decision; and/or
>
> c. the maximum prices set and advised to the Applicant and each other Franchisee for its Pizza ranges exceed the reasonable cost (as defined in paragraphs 9B, or alternatively 9C above) to be incurred in selling those respective Pizza ranges.
>
> Particulars
>
> (i) The duty of care arises at general law as a duty in tort; and/or
>
> (ii) The duty of care arises as an implied term of the IFA which is reasonable and necessary to give business efficacy to the IFA, and is so obvious as to go without saying;
>
> (iii) Yum receives a 6% Continuing Fee under the IFA for fulfilling its role as franchisor of the Pizza Hut System;
>
> 11A. The Yum Services for the purpose of paragraph 11 include:
>
> (a) Ownership, management and development of the System as

stated in paragraph 5 above;

(b) Preparation of plans and policies for the successful operation, marketing and development of the System in Australia; and

(c) Preparation of appropriate financial models and forecasts for the purpose of (b) above and/or for the purpose of exercise of its powers under the IFA.

286 Ground 11 of the notice of appeal relies on the finding, at [361] of the Reasons, that Yum oversees the System to establish the proposition that Yum provides services to Franchisees, which is put as the foundation of the alleged duty. The primary judge did not find that Yum provided any such services and it is doubtful whether it did so. Franchisees contract with Yum for the right to participate in Yum's System. They do not appear to contract with Yum for the provision of services by Yum to them.

287 In any event, in considering whether Yum owed Franchisees a duty of care, as alleged in the statement of claim, it is necessary to have regard to the contractual context of the relationship between Yum and the Franchisees: see *Astley v Austrust Ltd* (1999) 197 CLR 1 at [47]; *Brookfield Multiplex* at [127]-[132]; *Tomlin v Ford Credit Australia* [2005] NSWSC 540 at [124]-[125]; *National Australia Bank Ltd v Nemur Varity Pty Ltd* (2002) 4 VR 252 at [47]; *Simms Jones Ltd v Protochem Trading NZ Ltd* [1993] 3 NZLR 369 at 377. In circumstances where certain implied terms were alleged and rejected, it would be surprising if Yum were under a duty in tort to similar effect as the rejected implied terms. In our view, the duty of care alleged by DPL below, and relied upon now by the appellant, is simply inconsistent with the contractual relationship between Yum and each Franchisee. We do not think the fact that Yum contracts with each Franchisee on the same or substantially the same terms, or the fact that Yum operates a business system in which each Franchisee participates, alters the position. The economic interests of the parties are, in relevant respects, governed by the contract between them.

288 In light of the above, it is unnecessary to consider the question of breach. However, to the extent that the appellant relies on the facts and matters raised by grounds 1 and 3-10 of the notice of appeal, we refer to our reasons, above, in relation to those

grounds.

289 Accordingly, no error is shown in the primary judge's conclusion that DPL's negligence claim failed. We would dismiss ground 11.

WHETHER YUM'S CONDUCT WAS UNCONSCIONABLE WITHIN THE MEANING OF THE RELEVANT STATUTORY PROVISIONS

290 Ground 12 of the notice of appeal, set out at [146] above, relates to the appellant's statutory unconscionable conduct claim.

291 At trial, DPL alleged that Yum had contravened s 21 of the Australian Consumer Law. Section 21(1) provides, and provided at the relevant time, that a person must not, in trade or commerce, in connection with:

(a) the supply or possible supply of goods or services to a person (other than a listed public company); or

(b) the acquisition or possible acquisition of goods or services from a person (other than a listed public company),

engage in conduct that is, in all the circumstances, unconscionable. Section 21(4) provides that it is the intention of the Parliament that the section is not limited to the unwritten law relating to unconscionable conduct. It also provides that, in considering whether conduct to which a contract relates is unconscionable, a Court's consideration of the contract: may include consideration of the terms of the contract, and the manner in which and the extent to which the contract is carried out; and is not limited to consideration of the circumstances relating to formation of the contract.

292 Section 22 sets out a list of matters to which the Court may have regard for the purposes of determining whether a person has contravened s 21. Section 22(1) provides:

> Without limiting the matters to which the court may have regard for the purpose of determining whether a person (the ***supplier***) has contravened section 21 in connection with the supply or possible supply of goods or services to a person

(the ***customer***), the court may have regard to:

(a) the relative strengths of the bargaining positions of the supplier and the customer; and

(b) whether, as a result of conduct engaged in by the supplier, the customer was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the supplier; and

(c) whether the customer was able to understand any documents relating to the supply or possible supply of the goods or services; and

(d) whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the customer or a person acting on behalf of the customer by the supplier or a person acting on behalf of the supplier in relation to the supply or possible supply of the goods or services; and

(e) the amount for which, and the circumstances under which, the customer could have acquired identical or equivalent goods or services from a person other than the supplier; and

(f) the extent to which the supplier's conduct towards the customer was consistent with the supplier's conduct in similar transactions between the supplier and other like customers; and

(g) the requirements of any applicable industry code; and

(h) the requirements of any other industry code, if the customer acted on the reasonable belief that the supplier would comply with that code; and

(i) the extent to which the supplier unreasonably failed to disclose to the customer:

  (i) any intended conduct of the supplier that might affect the interests of the customer; and

  (ii) any risks to the customer arising from the supplier's intended conduct (being risks that the supplier should have foreseen would not be apparent to the customer); and

(j) if there is a contract between the supplier and the customer for the supply of the goods or services:

  (i) the extent to which the supplier was willing to negotiate the terms and conditions of the contract with the customer; and

  (ii) the terms and conditions of the contract; and

  (iii) the conduct of the supplier and the customer in complying with the terms and conditions of the contract; and

  (iv) any conduct that the supplier or the customer engaged in, in connection with their commercial relationship, after they entered into the contract; and

(k) without limiting paragraph (j), whether the supplier has a contractual right to vary unilaterally a term or condition of a contract between the supplier and the customer for the supply of the goods or services; and

(l) the extent to which the supplier and the customer acted in good faith.

293 In the statement of claim at [12], DPL alleged that, by giving directions or exercising rights or powers under the International Franchise Agreement, Yum supplied the services of a franchisor to each of the Franchisees in trade or commerce. At [24A]-[25] of the statement of claim, it was alleged that Yum contravened s 21 of the Australian Consumer Law.

294 The appellant's submissions in relation to the unconscionable conduct claim (which are expressed to be further or in the alternative to the contract and negligence claims) can be summarised as follows:

(a) This statutory claim, under s 21 of the Australian Consumer Law, is concerned with the circumstances and manner in which an otherwise valid exercise of power takes place.

(b) Unconscionable conduct has at its root the protection of vulnerable parties from the strong: *Paciocco v Australia and New Zealand Banking Group Ltd* (2015) 236 FCR 199 at [282] per Allsop CJ (Besanko and Middleton JJ agreeing). This is reflected in s 22(1)(a) of the Australian Consumer Law. As noted by the primary judge at [272] and [340], it was common ground that the "modern Australian commercial, business or trade conscience", as stated at [296] in *Paciocco*, was the correct test. In *Australian Competition and Consumer Commission v Lux Distributors Pty Ltd* [2013] ATPR 42-447; [2013] FCAFC 90 at [23], the Court noted that the task to be undertaken is an evaluation of the facts by reference to a normative standard, permeated with accepted and acceptable community values, including honesty and fairness.

(c) As the facts of this case demonstrate, the Franchisees were powerless to stop Yum announcing and implementing the Value Strategy – not by resigning from Adco, not by writing letters, not even by seeking an urgent interlocutory injunction, in

which Yum held the entire information advantage over the Franchisees. The absence of choice distinguishes the present case from the analysis of the High Court in *Paccioco v Australia & New Zealand Banking Group Ltd* (2016) 258 CLR 525 at [190], [288].

(d) Against this background, the appellant relies in particular upon the intended outcomes for the parties under the Value Strategy, as illustrated by the Yum Model. The primary judge found, at [388], that a 34.5% transaction increase was the point of the Value Strategy. At this point, Yum stood to increase its royalties by $2 million or 18%, with no increase in profit for the Franchisees, and the Franchisees bore the risk of loss at lower levels of transaction increase. The economics of this model became even more unfavourable for Franchisees if a more appropriate labour cost was used, as stated by Mr Potter.

(e) The Value Strategy was in substance a transfer of wealth to Yum from the Franchisees, equivalent to an increase in the rate of royalty by 18% – something that Yum had no entitlement to achieve directly under the International Franchise Agreement. This is a matter which the application of a business conscience, instructed by community standards, would not permit to be achieved indirectly through the use of Yum's maximum pricing powers: see *Australian Competition and Consumer Commission v Seal-A-Fridge Pty Ltd* (2010) 268 ALR 321 at [146].

(f) The primary judge made no findings in relation to this formulation of the unconscionable conduct case, which was pleaded and argued below, confining her consideration to an alternative formulation of the case, which relied upon the use of Australia as a test market for, and at the direction of, Yum US. The primary judge rejected that latter case at [391], which finding is not challenged on appeal and is not determinative of this cause of action.

295 The principles concerning unconscionable conduct were recently considered by the Full Court of this Court in *Colin R Price & Associates Pty Ltd v Four Oaks Pty Ltd* (2017) 120 ACSR 451; [2017] FCAFC 75 at [51]-[56] in relation to comparable provisions. The Full Court there referred to authorities including *Paciocco v Australia &*

New Zealand Banking Group Ltd (2016) 258 CLR 525; *Paciocco v Australia and New Zealand Banking Group Ltd* (2015) 236 FCR 199; and *Commonwealth Bank of Australia v Kojic* (2016) 341 ALR 572. In light of the discussion of principles and authorities in *Colin R Price* it is unnecessary for us to set out the applicable principles here.

296 Applying those principles in the present case, the appellant has not established that Yum's conduct was unconscionable within the meaning of s 21 of the Australian Consumer Law, having regard to the matters set out in s 22(1). We will assume, without deciding, that Yum was supplying services for the purposes of these provisions. In our view, the facts as found do not demonstrate conduct by Yum that was contrary to conscience (adopting, for present purposes, the notion of the "modern Australian commercial, business or trade conscience" referred to by Allsop CJ in *Paciocco* (2015) 236 FCR 199 at [296]). Addressing the matters referred to in s 22(1) (see *Paciocco* (2016) 258 CLR 525 at [189] and [293]-[294]), we make the following observations. In relation to (a), it may be accepted that Yum was in a stronger position than each of the Franchisees, but it may not be apt to describe this as a "bargaining position". In relation to (b), and treating the relevant conduct as the decision to adopt the Value Strategy (and set maximum prices accordingly), it is not shown that a Franchisee was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of Yum. Yum had a legitimate interest in adopting the Value Strategy. This is implicit in her Honour's finding at [368] that Mr Houston "made what he considered to be the best decision from the point of view of Yum and the future profitability of the Franchisees". Paragraph (c) of s 22(1) does not appear to be relevant here. In relation to (d), it is not shown that undue influence or pressure was exerted on, or that unfair tactics were used against, the Franchisees. Paragraphs (e), (f), (g) and (h) do not appear to be relevant. In relation to (i), while the Value Strategy undoubtedly involved risk for the Franchisees, it is not shown that Yum unreasonably failed to disclose such risks to the Franchisees. In relation to (j) and (k), Yum had power under the International Franchise Agreement to set maximum prices. In setting maximum prices as part of the Value Strategy, Yum was merely exercising that power. This did not involve

the unilateral variation of a term or condition, but the exercise of a power conferred on Yum under the agreement. Further, her Honour made important findings concerning Yum's exercise of the contractual power. Her Honour found that "Yum and, in particular Mr Houston, carefully considered the appropriate maximum price taking into account that it was part of an overall strategy" (at [363]). Her Honour also found that Mr Houston clearly believed, "rightly or wrongly but reasonably, that once Domino's offered an everyday $4.95 pizza, Pizza Hut had no choice but to implement the VS" (at [368]). In relation to (l), as discussed above, it is not shown that Yum failed to act in good faith. In light of these matters, we conclude that Yum's conduct was not unconscionable.

297 We note the appellant's submission that Yum stood to increase its royalties by $2 million or 18%, with no increase in profits for Franchisees, if there were a 34.5% uplift in transactions. We do not consider this matter to support or lead to a conclusion that Yum's conduct was unconscionable. Although her Honour said (at [388]) that the "point" of the Value Strategy was to bring about a 34.5% increase, this statement should not be taken out of context. In fact, the figure of 34.5% was the transaction uplift needed for the national average store to break even (see [80] above). It was not the predicted transaction growth. The ACT Test had shown higher transaction growth. Further, in light of the facts and matters referred to above, we do not consider this potential financial consequence to lead to a characterisation of Yum's conduct as unconscionable. There is no finding that this was the reason for the adoption of the strategy. To the contrary, the tenor of the findings is that the strategy was adopted having regard to the future profitability of both Yum and the Franchisees (see, eg, at [368]).

298 It follows that no error is shown in the primary judge's conclusion that DPL had failed to establish unconscionable conduct. We would dismiss ground 12.

CONCLUSION

299 In light of our conclusions in relation to grounds 1-13, it is unnecessary to deal

with ground 14, which concerns loss and damage.

300 For the reasons set out above, we would dismiss the appeal. In relation to the notice of contention, we would uphold ground 1; we do not consider it necessary to determine ground 2; and we would dismiss ground 3. There is no apparent reason why costs should not follow the event. Accordingly, we will also order that the appellant pay the respondent's costs of the appeal, to be taxed if not agreed. We will reserve liberty to apply in case there are matters relating to confidentiality that need to be dealt with.

I certify that the preceding three hundred (300) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justices Gilmour, Nicholas and Moshinsky.

Associate:

Dated: 28 November 2017